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Last page of docket

SHDKT PROCEEDINGS AND ORDERS DATE: [07/06/94]

CASE NBR: [93101338] CSX STATUS: [DECIDED]
SHORT TITLE: [J. Alexander Securities]
VERSUS [Mendez, Signe] DATE DOCKETED: [022294]
PAGE: [01]

	DATE	NOTE	PROCEEDINGS & ORDERS
1	Feb 22 1994	D	Petition for writ of certiorari filed.
3	Mar 7 1994		Waiver of right of respondent Signe Mendez to respond filed.
2	Mar 9 1994		DISTRIBUTED. March 25, 1994 (Page 3)
4	Mar 22 1994	P	Response requested -- WHR. (Due April 22, 1994)
6	Apr 18 1994		Order extending time to file response to petition until May 6, 1994.
7	May 6 1994		Brief of respondent Signe Mendez in opposition filed.
8	May 11 1994		REDISTRIBUTED. May 27, 1994 (Page 1)
10	May 16 1994	X	Reply brief of petitioner filed.
9	May 19 1994	X	Supplemental brief of petitioner filed.
12	May 31 1994		REDISTRIBUTED. June 3, 1994 (Page 14)
13	Jun 6 1994		Petition DENIED. Dissenting opinion by Justice O'Connor with whom The Chief Justice joins. (Detached opinion.)

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No. 93 1338

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

vs.

SIGNE MENDEZ,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL FOR THE SECOND APPELLATE DISTRICT

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QUESTIONS PRESENTED FOR REVIEW

SHOULD ARBITRATORS BE EMPOWERED TO AWARD PUNITIVE DAMAGES WHEN THE PARTIES' AGREEMENT IS SILENT ABOUT DAMAGES?

1. Rule 10.1(c). Can the extreme reluctance of courts to review arbitration awards be reconciled with the constitutional requirements for reasonable Due Process constraints on punitive damage awards enunciated in this Court's recent Haslip decision?

2. Rule 10.1(a). Is a New York choice-of-law provision in an arbitration agreement enforceable even if the effect is to prohibit arbitrators from awarding punitive damages or is there a federal substantive or "arbitration" law [i.e.

Federal Arbitration Act], which preempts the application of state law? Can the narrow reading of preemption by the Second Circuit in Fahnestock & Co. v. Waltman be reconciled with conflicting decisions of the First, Ninth and Eleventh Circuits?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases

Federal Statutes

State Statutes

Rules

Treatises and Other

No. _____

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PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL FOR THE SECOND APPELLATE DISTRICT

Ralph B. Perry III on behalf of J. Alexander Securities, Inc. ("Alexander"),[1] petitions for a writ of certiorari to review the decision of the

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[1] Petitioner has no parent or subsidiary corporations or affiliates.

California Court of Appeal in this case.

OPINIONS BELOW

The opinion of Division Two of the California Court of Appeal for the Second Appellate District is reported at 17 Cal.App.4th 1083, 21 Cal.Rptr. 2d 826 (1993). The trial court opinion of the Los Angeles Superior Court was not reported.

JURISDICTION

The decision of the California Court of Appeal (See Appendix A, infra) was filed on August 9, 1993. A timely petition for review was then filed with the California Supreme Court; the petition for discretionary review was denied on November 24, 1993, with two Justices voting for review (four votes

required for review) (App. B); by such denial, the Court of Appeal became the "state court of last resort." (Rule 13.1). Jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

STATEMENT OF THE CASE

Mendez opened a securities account with petitioner Alexander, a small Los

Angeles securities broker-dealer, by executing a Cash Account Agreement (the "Agreement") providing that any disputes be resolved by arbitration before the New York Stock Exchange, Inc. ("NYSE") or the National Association of Securities Dealers, Inc. ("NASD"). C1:13-14 (¶ 9).[2] The Agreement also provided that its interpretation and enforcement would be governed by New York law. Id. (¶ 4).

After the value of the securities in the account declined, Mendez accused Weber, her broker of thirty years, and Alexander of churning, unsuitability and unauthorized trades. Originally Mendez sought only compensatory damages but

[2] Other than attached Appendix (A, B and C) all references are to pages of the official appendix of the record on appeal (any cite with "App." is to the attached Appendix).

later she amended her claim to seek additional compensatory damages and also punitive damages. Mendez chose arbitration pursuant to the Rules and Regulations of the NASD.[3] The matter was heard in Los Angeles by three arbitrators[4] and they rendered an award in March, 1992, consisting of four brief paragraphs: the first paragraph awarded $27,000 in compensatory damages against

[3] A complete set of the NASD Rules is set forth at C9:192-211.

[4] The Opinion states more than once that the three arbitrators were selected by the parties. App. A31. This is not correct. The arbitrators are selected by the NASD with each party having one peremptory challenge. The Opinion also suggests there is actually a benefit from the arbitrators being "from the trade." App. A31-32. This too is incorrect; NASD rules require that in matters involving public customers a majority of the panel must not be from the securities industry. See NASD Code of Arbitration, § 19 (App. C4).

the broker (Weber) and the firm (petitioner Alexander); the second paragraph awarded $27,000 in punitive damages against petitioner Alexander only for "failure to meet its duty and obligation to supervise [Weber]"' and the third and fourth paragraphs dealt with costs, fees and interest. C1:16.

Petitioner filed in the California Superior Court a Petition to Correct Arbitration Award by which petitioner sought only correction by eliminating the second paragraph providing for punitive damages, without affecting the merits of the decision, or the compensatory award, or the provisions for costs, fees and interest.[5] Petitioner argued to the

[5] "The arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision upon the controversy submitted."

trial court that the punitive damage portion of the award was in excess of the arbitrators' powers because there was no express agreement to submit to punitive damages and there were (1) no Due Process safeguards or constraints to such an award as required by this Court's decision in Pacific Mutual Life Ins. Co. v. Haslip, 499 U.S. 1, 111 S.Ct. 1032, 113 L.Ed. 2d 1 (1991); and (2) the parties' choice of law provision provided for the application of New York law and under such law arbitrators were prohibited from awarding punitive damages under Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 1354, 353 N.E.2d 793 (Ct. of App. 1976). (C1:30-38).

The petition was heard by the trial

California Code of Civ. Proc., § 1286.6(b); see also §1285. App. C2-3.

court and denied without a statement of decision, (C12:215), and judgment was entered denying the petition and confirming the award on August 24, 1992. (B:4-5). An appeal was taken and the California Court of Appeal for the Second Appellate District affirmed by its written opinion filed August 9, 1993. (App. A). Thereafter a Petition for Review was filed in the California Supreme Court, which was denied on November 24, 1993, with two Justices (of four votes required) voting for review. (App. B). The denial formally rendered the California appellate court the "state court of last resort." (Rule 13.1).

The California Appellate Court gave the constitutional argument short shrift, relying on prior California and Ninth Circuit cases which did not deal with

Haslip at all.[6] The California court also held that the arbitrators had not exceeded their powers in awarding punitive damages for two reasons: (1) federal preemption cases held that a choice of law provision did not deprive the arbitrators of authority to award punitive damages but only provided the substantive law as to whether given conduct would warrant punitive damages, see Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1978 (11th Cir. 1988); and (2) without any express language in their contract but given the strong policies favoring arbitration the agreement could still be read as "contemplating" an award of punitive damages.

REASONS FOR GRANTING THE WRIT

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[6] See further discussion of these cases at pp. 22-24 infra.

I. THE DECISION OF THE STATE COURT BELOW, IN UPHOLDING AN ARBITRATION AWARD OF PUNITIVE DAMAGES IN THE ABSENCE OF ANY EXPRESS AGREEMENT BY THE PARTIES AS TO PUNITIVE DAMAGES, CONFLICTS WITH THE REASONABLE DUE PROCESS CONSTRAINTS ON SUCH PUNITIVE AWARDS REQUIRED BY THIS COURT'S 1991 HASLIP DECISION.

In this Court's recent decision in Pacific Mutual Ins. Co. v. Haslip, supra, punitive damages barely withstood a challenge that such damages were a per se violation of a defendant's due process rights. Justice O'Connor, in her dissent, carefully catalogued the dangers of the "powerful weapon" of punitive damages with highly vague instructions resulting in an almost standardless discretion to the jury or trier of fact.

111 S.Ct. at 1056. Justice O'Connor argued that post-verdict judicial review could not cure such faulty procedures and that Alabama's punitive damages scheme was indistinguishable from the common law schemes employed by many states. "Any award of punitive damages rendered under these procedures, no matter how small the amount, is constitutionally infirm." 111 S.Ct. at 1056 (O'Connor, J., dissenting). Other members of this Court have indicated due process concerns with punitive damages. See, e.g., Browning-Ferris Indus. v. Kelco Disposal, Inc., 492 U.S. 257, 278, 109 S.Ct. 2909, 2921 (1989).

Justice Blackman, writing for the majority of the Court, in Haslip held that the common law method for assessing punitive damages was not "per se

unconstitutional." The core of the majority opinion then was that analyzing Alabama judicial procedures from instructions to the jury and its post-trial procedures for scrutinizing punitive damage awards, including review by the trial court and the Alabama Supreme Court, and noting that Pacific Mutual had had the benefit of the "full panoply of Alabama's procedural protections," held that: "The application of these standards, we conclude, imposes a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages." 111 S.Ct. at 1045, 1046.

The Court refused to draw a "mathema tical bright line" in Haslip as to the amount of punitive damages which could be

considered "excessive."[7]

Usually an arbitration award will not be set aside in the c urts unless it evidences a "manifest disregard for law." See, e.g., United Steel Workers v. American Mfg. Co., 363 U.S. 564, 80 S.Ct. 1343, 4 L.Ed.2d 1403 (1960). Recently, the California Supreme Court went much further and in a "significant shift in California law toward private dispute resolution" (see App. A11), took perhaps the final step in embracing the judicial hands-off approach to arbitration awards

[7] In Haslip the punitive damages were 4 times the amount of compensatory damages. Subsequently this Court upheld an award 526 times greater than the actual damages awarded by the jury but which was still held not excessive enough in amount, where there were sufficient procedural constraints, to be deemed an arbitrary deprivation of property without due process of law. TXO Prod. Corp. v. Alliances Resources Corp., ___ U.S. ___, 113 S.Ct. 2711 (1993).

by rejecting judicial review even in the limited instance of a manifest error of law appearing on the face of the award itself and where that error causes substantial injustice. Moncharsh v. Heily & Blase, 3 Cal.4th 1, 10 Cal.Rptr.2d 183 (1992).

Whether or not one views arbitration favorably or unfavorably, it certainly has fewer, if any, safeguards against error. Arbitrators can ignore or erroneously apply the law, refuse to follow any rules of evidence, and make findings and conclusions unsupported by any evidence. Usually no record of the arbitration proceedings exists. Meaningful review of such awards by courts for errors of law or procedure is virtually impossible; and rightfully so, for any increase in judicial intervention

cuts against arbitration's critical benefits of quicker decisions and more reasonable costs. The increasing desire of overburdened courts is to provide essentially no judicial review so that the "arbitrator's decision should be the end, not the beginning of the dispute."[8]

The popular and pervasive hands-off judicial role for review of arbitration awards, however, cannot coexist with the constitutional due process requirements of Haslip. Arbitrators are free not to follow rules of evidence and they may misinterpret or misapply the law. There are simply no constraints on the arbitrator's decision, reasonable or otherwise, and no requirements for punitive damage procedures or punitive

[8] Moncharsh, supra, 3 Cal.4th at 10, 10 Cal.Rptr.2d at 187.

damage review once awarded.

At the same time as it has become next to impossible to obtain any judicial review of arbitral punitive damage awards, many states, including California,[9] are making it increasingly

[9] In a landmark decision, the California Supreme Court eliminated the availability of punitive damages for the tort of wrongful termination. See Foley v. Interactive Data Corp., 47 Cal.3d 654, 254 Cal.Rptr. 211 (1988). In Adams v. Murakami, 54 Cal.3d 105, 284 Cal.Rptr. 318 (1991), the California Supreme Court refused to uphold any punitive damage award unless evidence had been presented to the fact finder as to the wealth of the defendant. 1987 and later amendments to the California Civil Code § 3294 require a bifurcated trial with a higher evidentiary standard of "clear and convincing evidence" applicable to the punitive damage phase; for an employer to be liable for punitive damages for the acts of an employee, the employer has to have "advance knowledge" of the employee's unfitness or must have expressly "authorized or ratified" the employees' conduct. In the instant case there was no evidence ever presented to the arbitrators as to the wealth of petitioner. (C1:40).

more difficult to recover punitive damages in the courtroom. Although a few appellate courts in California have upheld this State's judicial procedures for the award of punitive damages as meeting the due process requirements of Haslip,[10] the California Supreme Court has not ruled directly on the question; however, in speaking of the Haslip decision, that Court acknowledged that with Haslip the punitive damage question "recently acquired a federal constitutional dimension" and given California's standard of punitive damage review which looks only to whether the award was the result of "passion or

[10] See, e.g., MGW, Inc. v. Fredericks Dev. Corp., 5 Cal.App.4th 92, 6 Cal.Rptr.2d 888 (1992); Las Palmas Assocs. v. Las Palmas Center Assocs., 235 Cal.App.3d 1220, 1 Cal.Rptr.2d 301 (1991).

prejudice" the California high court asked the provocative question of whether California's system might be closer, not to the Alabama system, but to the Vermont and Mississippi systems about which this Court has previously expressed its concern in prior cases.[11] The California Supreme Court concluded its discussion of Haslip by noting that "at a minimum, however, the high court has made clear a constitutional mandate for

[11] Citing Browning-Ferris, supra; and Bankers Life and Cas. Co. v. Crenshaw, 486 U.S. 71, 108 S.Ct. 1654, 100 L.Ed.2d 62 (1988); the California Supreme Court observed: "The California standard of review appears to be similar to those as to which the high court noted its concern." Adams v. Murakami, supra, 54 Cal.3d at 118 n.9, 284 Cal.Rptr. at 326 n.9. The Ninth Circuit also noted that its standard of "manifestly and grossly excessive" did not comport with due process. Searle v. Morgan, 997 F.2d 1244, 1258 (9th Cir. 1993) (citing Haslip, 111 S.Ct. at 1045 n.10).

meaningful judicial scrutiny of punitive damage awards." Adams v. Murakami, 54 Cal.3d at 118, 284 Cal.Rptr. at 326. Should it eventually be determined either by this Court (or the California Supreme Court) that California's judicial procedures are inadequate to assure punitive damages scrutiny in compliance with Haslip, the anomalous result might be that punitive damages would not be recoverable in California courts but arbitrators in this state would continue to be empowered to render wholly unreviewable punitive damage awards.

The appellate opinion in this case gave little recognition and only superficial analysis of the due process argument stating that "similar" arguments had been made and rejected in California, citing Todd Shipyards Corp. v. Cunard

Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); and Baker v. Sadick, 162 Cal.App.3d 618 (1984). App. A30-33. Of course, neither of these cases dealt with Haslip at all. Baker was decided seven years before Haslip and simply stated that where the party did not have a "plain and clear" mutual understanding that punitive damages would not be awarded, the court could affirm such an award. The Todd opinion was actually issued after the Haslip decision was rendered, but Todd was briefed, argued and submitted for decision three months before Haslip, and did not reference or purport to address Haslip in any manner. In that case, defendant Cunard had made the broadest conceivable argument that the "absence of rules of evidence . . . create a substantial likelihood of an

erroneous award" and therefore violates due process.[12] Todd correctly noted that such an argument could be made to attack any arbitration award, rejecting the tired argument that all of the "formalities" or "procedural strictures" of the courtroom were necessary for due process. 943 F.2d at 1063. Thus the California Appellate Court did not offer any analysis of its own, relied on two cases that had never considered Haslip and simply fell back on the policies favoring arbitration as an alternative dispute resolution forum. App. A33-34.

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[12] This Court rejected this broad argument that arbitration denies parties due process rights to a fair hearing. Matthews v. Eldridge, 424 U.S. 319, 96 S.Ct. 893 (1976). In our case, when the appellate court referred to the fact Alexander had "notice" of a punitive damage claim (see App. A30), this did not address Haslip but only the Matthews v. Eldridge issue.

Only one federal appellate case has been located where Haslip was expressly examined in the context of judicial review of arbitration awards of punitive damages. In Lee v. Chica, 983 F.2d 883 (8th Cir.), cert. denied, 1993 U.S. Lexis 4209 (1993), the parties apparently did not argue, and thus the majority did not cite Haslip nor even consider whether the punitive damage award under the rules of the American Arbitration Association ("AAA") contravened the due process clause. However, Judge Beam, in a carefully considered dissent, analyzed the ramifications of the Supreme Court's analysis in Haslip. He noted that the arbitration agreement, which incorporated the AAA rules, nowhere mentioned punitive damages. Judge Beam observed it would be unconstitutional, absent express

authorization or consent of the parties, to interpret the arbitration agreement as empowering an arbitrator to award punitive damages:

> In the arbitration setting we have almost none of the protections that fundamental fairness and due process require for the imposition of this form of punishment. Discovery is abbreviated if available at all. The rules of evidence are employed, if at all, in a very relaxed manner. The fact finders (here the panel) operate with almost none of the controls and safeguards assumed in Haslip. Here . . . . the scope of review of the arbitrator's award is narrowly

limited if not almost nonexistent. . . . This standard of review, of course, almost completely ignores the review required by Haslip. Why should less be required in an Arbitration proceeding if, indeed, punitive damages are within the scope of AAA Rule 43? The simple answer is that

> the rules do not contemplate an award of punitive damages.

983 F.2d at 889 (Beam, dissenting).

No concept of waiver of the constitutional due process requirements in the award of punitive damages can be derived from policies favoring arbitration or from the parties' general agreement to submit their disputes to arbitration. For an effective waiver of

a constitutional right, much more is required than inference or implication--a knowing and express waiver is required. Fuentes v. Shevin, 407 U.S. 67, 94-96, 92 S.Ct. 1983, 2001-02, 32 L.Ed.2d 556 (1972). Waivers of fundamental constitutional guarantees are subject to the "most stringent scrutiny" and "courts will indulge every presumption against a finding of waiver." Bueno v. City of Donna, 714 F.2d 484, 492 (5th Cir. 1983). This standard requires an express agreement to submit a punitive damage claim to arbitration. No party can be deemed to waive due process rights without actual knowledge of such rights, a full understanding of their meaning and clear comprehension of the consequences

of any waiver.[13] Id. at 493; see also,

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[13] The Appellate Court in this case had the waiver issue backwards, arguing that it was "doubtful that [the customer] had the opportunity to negotiate any of its [the Agreement's] terms." App. A26. This is not true; also, many securities firms do not require agreements for cash accounts, so Mendez could easily have gone elsewhere without agreeing to arbitration. Furthermore, the Court noted that the customer, as "a consumer residing in Los Angeles" could not be expected to know New York law and the NASD Rules and therefore should not be held to have waived her rights to punitive damages. Id. But this is contrary to the basic idea that parties are generally free to structure their arbitration agreements as they see fit. Volt, supra, 468 U.S. at 478-79, 109 S.Ct. at 1255-56. Furthermore, imposing requirements on brokers to explain all the legal effects of choice of law is bad policy. One federal case involving a securities arbitration discussed this precise issue:

> A review of the cases that discuss the breadth of a securities broker's fiduciary obligation to the customer leads to the inescapable conclusion that the broker's duty does not require an explanation of the choice of law provision and the agreement to arbitrate.

Gouger v. Bear, Stearns & Co., 823

Wellen v. Cooper, 828 F.2d 1471, 1474 (10th Cir. 1987).

Contrary to the appellate opinion in this case, this Court has already acknowledged that Haslip clearly demands that to comport with constitutional requirements of due process, there must be meaningful judicial scrutiny of punitive damage awards. The absence of sufficiently definite and meaningful constraints upon arbitrators in the award of punitive damages runs directly contrary to the minimum procedural safeguards required in Haslip and

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F.Supp. 282, 286 (E.D. Pa 1993). The Gouger court noted strong public policy reasons against imposing a rule that brokers explain the effect of a choice-of-law provision to their customers. It was too burdensome and unrealistic to expect non-lawyer brokers to explain all the nuances of the application of New York law, only one such nuance being the inability to award punitive damages under that state's law. 823 F.Supp. at 287-88.

violates defendant's constitutional rights of due process.[14] With the pervasive trend favoring arbitration (see Moncharsh), there are basically no constraints, meaningful or otherwise, on an arbitrator's imposition of these "windfall" damages which represent a "boon" for the plaintiff "perhaps justified for societal reasons of deterrence. . . ." Adams v. Murakami, supra, 54 Cal.3d at 120, 284 Cal.Rptr. at

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[14] There is uncertainty over whether ample pre-judgment constraints can make up for infirmities in post-judgment review; although not important to this case where there are no constraints on arbitrators at any point in the process, such uncertainty may be resolved as a result of this Court's grant of certiorari on January 14, 1994, in Oberg v. Honda Motor Co., 316 Ore. 263, 851 P.2d 1084 (1993).

327.[15] Combining meaningful judicial scrutiny and judicial hands-off policies is like mixing gasoline and water. It cannot be done. Without a party's express agreement or consent to an award of punitive damages, such an unreviewable award violates fundamental rights to due process of law. Petitioner is entitled to correction of the award to strike only the portion relating to punitive damages.

II. THE DECISION BELOW THAT AS TO THE ISSUE OF PUNITIVE DAMAGES FEDERAL SUBSTANTIVE LAW WAS APPLICABLE AND THUS THE PARTIES' CHOICE OF NEW YORK

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[15] Scholars have suggested that fairness requires that any punitive damage award go to the state and not to individual litigants. See, e.g., E. Jeffrey Grube, Punitive Damages: A Misplaced Remedy, 66 U.S.C. L. REV. 839 (1993).

LAW COULD BE IGNORED UNDER THE DOCTRINE OF PREEMPTION [FEDERAL ARBITRATION ACT], ALTHOUGH SUPPORTED BY SOME CIRCUIT COURTS, CONFLICTS WITH DECISIONS OF THE SECOND CIRCUIT AND WITH SOUND LOGIC.

Petitioner asserted the parties' choice of law agreement as a separate and independent ground for its petition for correction to strike the punitive damage award. (C1:11, 23-26). The customer's Cash Agreement contained, in addition to the arbitration provisions, a clause that provided, "This Agreement and its enforcement shall be governed by the laws of the State of New York." (C1:13).

The California Appellate Court never questioned petitioner's citation of New York law: that Court agreed that under New York law arbitrators have no power to

award punitive damages. Indeed such damages are not a private compensatory remedy and thus if awarded by arbitrators, such an award is violative of public policy. The leading case in New York is Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 1354, 353 N.E.2d 793 (Ct. of App. 1976) (C1:30). Garrity based its holding on policy grounds remarkably similar to the constitutional concerns expressed in Haslip. The Garrity Court quoted the following from a prior decision with approval:

> "The trouble with an arbitration[sic] admitting a power to grant unlimited damages by way of punishment is that if the court treated such an award in the way arbitration awards are usually treated, and

followed the award to the letter, it would amount to an unlimited draft upon judicial power. In the usual case, the court stops only to inquire if the award is authorized by the contract; is complete and final on its face; and if the proceeding was fairly conducted.

"Actual damage is measurable against some objective standard--the number of pounds, or days, or gallons or yards; but punitive damages take their shape from the subjective criteria involved in attitudes toward correction and reform, and courts do not accept readily the delegation

of that kind of power. Where punitive damages have been allowed for those torts which are still regarded somewhat as public penal wrongs as well as actionable private wrongs, they have had rather close judicial supervision. If the usual rules were followed there would be no effective judicial supervision over punitive awards in arbitration." 353 N.E.2d at 796 (C1:33).

The New York court noted that imposing penal sanctions in private arrangements violates the rule of law requiring that the use of coercion and the imposition of social sanctions must be reserved to the state, through its

courts and juries.[16] New York cases continue to uphold Garrity.[17]

The choice of law provision, specifying New York law, controls. Here there are some minimum contacts with New York.[18] However, even if there was not,

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[16] Other states deny arbitrators the power to award punitive damages; these include Colorado, Minnesota, Nebraska, New Mexico, New Hampshire.

[17] See, e.g., Belco Petroleum Corp. v. AIG Oil Rig, Inc., 565 N.Y.S.2d 776, 784 (1st Dep't 1991); see also Fahnestock, infra.

[18] Although Petitioner Alexander is a small California broker-dealer, it is a member of the NASD which itself is headquartered in New York; Claimant Mendez's trades were mostly executed on the New York Stock Exchange; and all transactions in Claimant Mendez's account were cleared through Pershing, a division of Donaldson Lufkin & Jenrette Securities Corp., headquartered in New York. This formed the basis for the California Appellate Court's determination that the Cash Account Agreement evidenced a transaction in "interstate commerce."

the choice of law provision is enforceable. Parties can agree on a choice of law, even when there is no relationship to the state specified to the contract. As Professor Witkin has stated: "If the parties have designated the law of a particular state, the court will apply that law, even though the state has no relationship to the contract." 1 WITKIN, SUMMARY OF CAL. LAW, Contracts, § 63, p. 100 (9th ed. 1987); accord RESTATEMENT SECOND, Conflict of Laws, § 204.

Here it is undisputed that the parties expressly agreed to the application of New York law. New York law emphatically denies arbitrators the power to award punitive damages and no good reason exists for refusing to

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App. A13.

enforce the parties' agreement. Even if this case had come up through the federal courts under the FAA, state law would be applicable either because of the parties' express agreement or pursuant to accepted principles of diversity. The reason for this was explained by this Court in Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1982):

> "The arbitration agreement . . . creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent, federal-question jurisdiction. . . . hence, there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue." 460 U.S. at 25, n.32,

103 S.Ct. at 942, n.32.

In this case the California Appellate Court ignored the parties' agreement and settled principles of choice of law by asserting that the issue of whether arbitrators can award punitive damages is part of a body of "federal substantive law." Other than general statements about the purpose and effect of the FAA to encourage arbitration of civil disputes and to resolve the doubts concerning the scope of arbitrable issues in favor of arbitration as emphasized by this Court in Southland Corp. v. Keating, 465 U.S. 1, 10-12, 104 S.Ct. 852, 859, 79 L.Ed.2d 1, 13 (1984); or in Moses H. Cone, supra, 460 U.S. at 24-25, the authority for this proposition is found in Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1387 (11th Cir. 1988).

In Bonar the parties' agreement provided for arbitration under the AAA Commercial Arbitration Rules and also contained a New York choice-of-law provision. Judge Kravitch held that AAA Rule 43, providing that an "arbitrator may grant any remedy or relief which he deems just and equitable and within the scope of the agreement of the parties," [emphasis added] authorized the arbitrators to award punitive damages in the absence of a choice-of-law provision; but then after acknowledging that the Garrity rule in New York prohibited arbitrators from awarding punitive damages, Judge Kravitch concluded that the addition of the choice-of-law provision did not deprive the arbitrators of that power: "Thus, a choice-of-law provision in a contract governed by the

Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damage; it does not deprive the arbitrators of their authority to award punitive damages." 835 F.2d at 1387.

In subsequent cases under the rules of the AAA, Bonar has been followed by the 1st and 9th Circuits. Raytheon Co. v. Automated Business Sys., Inc., 882 F.2d 6 (1st Cir. 1989); Todd Shipyards Corp. v. Cunard Line, Ltd., supra; cf. Howard P. Foley Co. v. International Bhd. of Elec. Workers, Local 639, 789 F.2d 1421 (9th Cir. 1986) (arbitrators lack power to award punitive damages in labor disputes absent an express provision in the contract).

The preemption issue was carefully

analyzed by the 2nd Circuit in Fahnestock & Co. v. Waltman, 935 F.2d 512 (2nd Cir. 1991). Judge Miner in Fahnestock approved a New York Stock Exchange ("NYSE") arbitration award of compensatory damages but reversed the award of punitive damages on the basis of Garrity and the normal application of New York law in a diversity case. As stated by this Court, the general rule in diversity cases is that where "state law provides the basis for decision, the propriety of an award of punitive damages for the conduct in question" is a matter of state law. Browning-Ferris, supra, 492 U.S. at 278, 109 S.Ct. at 2922. Further, as this Court held in Volt Info. Sciences v. Board of Trustees of Leland Stanford Jr. Univ., 489 U.S. 468, 477, 109 S.Ct. 1248, 1254, 103 L.Ed.2d 48,

(1989), "The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." This Court in Volt permitted the application of state law in arbitration matters, subject to a narrow reading of preemption only in those cases where "it actually conflicts with federal law." Id.

The concept of federal preemption under the FAA was developed in response to state laws that restrict arbitration in derogation of agreements freely negotiated. See, e.g., Perry v. Thomas, 482 U.S. 483, 489-90, 107 S.Ct. 2520, 2525-26, 96 L.Ed.2d 426 (1987). Fahnestock concluded with this analysis:

> [S]tate law relating to the propriety of a punitive damages award in the absence of an

agreement on the subject is not preempted by any federal substantive law bearing on the subject.

. . .

It follows that in this action the Garrity rule prohibiting the award of punitive damages by arbitration must be applied. That the rule is grounded in state policy concerns renders it no less a rule of substantive law. 935 F.2d at 518.

Fahnestock was soon followed by the 2nd Circuit opinion in Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117 (2nd Cir. 1991) which involved an NYSE arbitration award of both compensatory and punitive damages where the parties had an express choice-of-law provision in their contract. The court

held that, "The Barbiers contend that the choice-of-law clause incorporates only state substantive law, and not state arbitration law. Like the district court, they characterize Garrity as arbitration law rather than substantive law. We already have held that the measure of damages is a matter of state substantive law, see Fahnestock. . . . " 948 F.2d at 122.[19]

Although Fahnestock and Barbier appear to be by far the better reasoned cases on the federal preemption issue, there is another way to explain Bonar and

[19] Ironically, the California appellate decision after making an argument for the preemption of federal substantive law, rejects Fahnestock and Barbier on the sole ground that they are "in direct contravention of the prevailing policy in California" citing two cases in California which upheld arbitration awards of punitive damages. See App. A23.

its progeny by concluding there is no genuine conflict between Fahnestock and Bonar. As noted above, Bonar, Raytheon and Todd Shipyards, supra, all relied heavily on the broad language in AAA Rule 43 concerning the arbitrators' authority to fashion "any remedy or relief" deemed "just and equitable."[20] Although there is not the slightest reference even in the AAA Rules to punitive damages, there is at least the weak argument that these vague and broad words such as "remedy" somehow support the conclusion that agreeing to arbitration under the AAA constitutes agreement or consent to an

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[20] In California, this same broad language in AAA Rule 43 was rejected as authority for allowing a party to recover attorneys' fees where such fees were not expressly agreed in the parties' contract. See Thompson v. Jesperson, 222 Cal.App.3d 964, 272 Cal.Rptr. 132 (1990); and see Collins v. Luster, infra.

award of punitive damages.[21]

Moreover, and more importantly, the arbitration in the instant action was one under the auspices of the NASD and not under the AAA. The NASD Arbitration Rules do not mention punitive damages, nor do they even contain any vague rules relating to remedies such as contained in

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[21] Textbooks often categorize punitive damages as a type of legal "remedy." The fallacy of this is that the most widely accepted justification for punitive damages is deterrence, not compensation. For purposes of deterrence, punitive damages are not really a remedy at all; their design is prospective, not retrospective. If they do serve as a remedy, they remedy harm to society as a whole, not harm to civil plaintiffs who are otherwise compensated to the extent society chooses to compensate them. When paid to civil plaintiffs, punitive damages are a windfall and are to that extent "misplaced." Grube, supra at 880.

AAA Rule 43. Notably, the Fahnestock and Barbier cases, supra, which the Appellate Court here flatly refused to follow, involved NYSE arbitrations where the rules are substantially similar to the NASD rules; neither the NYSE or NASD has any provision remotely comparable to AAA Rule 43. "[T]he NYSE Rules have no provisions relating to remedy or relief. Clearly, if the NYSE wanted to empower arbitrators to award punitive damages it could have done so." Fahnestock, supra, 935 F.2d at 519. Finally, the cases relying on AAA Rule 43 to justify arbitration awards of punitive damages simply ignore the second part of the rule stating that any remedy or relief, must be "within the scope of the agreement of the parties."

III. IN ADDITION TO DUE PROCESS AND PREEMPTION CONCERNS, SOUND CONTRACT LAW AND PUBLIC POLICY SUGGEST THAT THE DRASTIC SANCTION OF PUNITIVE DAMAGES, WHICH EMBODIES THE DUAL SOCIETAL GOALS OF PUNISHMENT AND DETERRENCE, SHOULD ONLY BE PERMITTED TO BE IMPOSED IN ARBITRATION WITH THE EXPRESS AGREEMENT OF THE PARTIES.

Certainly it is clear that petitioner intended and expected Garrity to apply and that the arbitrators would not have the power to award punitive damages. As noted in Barbier, supra, "We need not look to the Fahnestock rationale to determine whether Garrity should be applied here, because the language of the parties' Agreement is clear: 'This Agreement shall . . . be governed by the

laws of the State of New York.'" 948 F.2d at 122. Further, the laws of New York or California or the intent and purpose of the FAA itself all require that private agreements to arbitrate be enforced in accordance with their terms. Even in Bonar, Circuit Judge Tjoflat stated in a concurring opinion,

> I can understand how, in an appropriate case, an arbitrator may find that an award of punitive damages would be 'just and equitable.' I have difficulty, however, understanding how punitive damages can ever be considered 'within the scope of the agreement of the parties' absent some express provision in the contract.' 835 F.2d at

1388.

Although arbitrators should have flexibility to fashion appropriate remedies upon the submission of contractual and other disputes to arbitration, the scope of such remedies should be limited to making any injured party whole and,

> Whether that scope can fairly be said to encompass the assessment of a penalty for wilful or wanton misconduct, however, is extremely doubtful. Punitive damages are designed to serve the societal functions of punishment and deterrence; unlike contract remedies, they are not designed to vindicate the parties' contractual bargain. Consequently, absent

> an express provision in the contract, punitive damages should be considered as outside the scope of the parties' agreement and beyond the power of the arbitrator to award. Id. at 1389.[22]

Even in the California Supreme Court's recent Moncharsh decision, reflecting the extreme reluctance of courts to interfere with arbitration awards even where there is manifest error on the face of the award which could result in substantial injustice, the court was very careful to note that "Moncharsh does not argue that the arbitrator's award strayed beyond the

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[22] These same thoughts were echoed by Judge Beam in his dissenting opinion in Lee v. Chica quoted in Part I above.

scope of the parties' agreement by resolving issues the parties did not agree to arbitrate."[23] In the instant case, the NASD arbitrators clearly strayed beyond the parties' agreement and as noted by the California Appellate Court, "A review of the Cash Account Agreement reveals that appellant is correct; there is nothing contained therein which either expressly includes or excludes awards of punitive damages." App. A17.

On the merits of its dispute with its customer, petitioner Alexander had substantial factual and legal arguments that it was not liable for any compensatory damages or that such damages were excessive; however, the decision in

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[23] Moncharsh, supra, 3 Cal.4th at 28, 10 Cal.Rptr.2d at 200.

that regard and the amounts the arbitrators determined were sufficient to make the claimant whole were clearly within the intended scope of the arbitration agreement and thus were not, and are not here, challenged. These issues were precisely those expected to be resolved by the arbitrators, falling squarely within the four corners of the arbitration agreement. The compensatory damages awarded recouped for the customer every dollar the arbitrators believed was lost as a result of any conduct by petitioner and its broker. However, punitive damages, which encompass societal goals of punishment and deterrence, go well beyond the merits of the dispute and do not constitute an issue the parties agreed to arbitrate. The difficult case on the issue of FAA

preemption will come where the parties have agreed on the application of New York law, including Garrity, but where the parties also have expressly agreed to a potential punitive damage award. See Fahnestock, supra, 935 F.2d at 518. This is not such a case. There was no agreement on punitive damages, period. Because arbitration is strictly a creature of contract, any award of punitive damages by an arbitrator, when not agreed to or consented to by the party against whom they are imposed, results in the arbitrator exceeding his powers under the agreement.

IV. CONCLUSION

The unfettered and unreviewable discretion of arbitrators to award punitive damages violates petitioner's

constitutional rights to due process as enunciated by Haslip. How can we allow arbitrators in California to mete out standardless unreviewable awards of punitive damages to punish and deter while courts and juries in this State are precluded by due process constraints from awarding such damages absent bifurcated separate proceedings, a greater burden of proof by clear and convincing evidence, and heightened scrutiny and review at every stage of the judicial process?[24]

The award of punitive damages in this case by the NASD arbitrators went far

[24] Indeed, as noted above, if the California Supreme Court determines that California's judicial process does not pass constitutional muster under Haslip, we could have the anomalous result that punitive damages would not be recoverable at all in California courts but arbitrators in this State could continue to render standardless and unreviewable punitive damage awards.

beyond the scope of the parties' basic agreement to submit the controversy for resolution to arbitration, went beyond any rules or powers delegated to the arbitrators by the NASD, and flew in the face of an express choice of law provision agreed to by the parties providing for the application of New York law which precludes arbitrators awarding punitive damages.

The California Court of Appeal purported to base much of its decision on general policy arguments favoring arbitration as an alternative dispute resolution forum (App. A33); it is most important to note that requiring that the parties expressly agree to the drastic sanction of punitive damages is not inconsistent with this general policy. In a recent California case, an

arbitrator had granted certain equitable relief pursuant to express agreement of the parties; but when his injunctive awards were ignored and he imposed monetary sanctions to enforce compliance, the court held that the arbitrator exceeded his powers because nothing in the arbitration agreement expressly authorized such sanctions. Collins v. Luster, 15 Cal.App.4th 1338, 19 Cal.Rptr.2d 215 (1993). Although a court would have had inherent power to enter such an order, the Luster court refused to "infer" such power despite the broad nature of the submission. A key advantage to arbitration is that parties have always been allowed to structure their agreements as they see fit (Volt, supra, 468 U.S. at 478-79, 109 S.Ct. 1255-56); it is wholly consistent with

that policy that arbitrators be allowed to enforce only such significant remedial powers to which the parties have clearly and expressly agreed. This is sound policy even if this Court had not held that "unlimited judicial discretion [let alone unlimited arbitral discretion] . . . in the fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities." Haslip, supra, 111 S.Ct. at 1043.

This Court should resolve this constitutional question of first impression, and of nationwide importance to the increasing use of arbitration as an alternative to our overburdened courts, by holding that arbitrators cannot constitutionally award punitive damages without the express agreement of the parties. Such a decision will not

discourage alternative dispute resolution nor will it impact at all any arbitration awards compensating injured parties for ~~all~~ loss and damage suffered.

Further, should this Court determine that any conflict exists between the Federal Courts of Appeals on the preemptive effect of the FAA as it relates to the remedy of punitive damages, such conflict should be resolved by this Court.

Pursuant to Rules of this Court, petitioner Alexander respectfully prays that a writ of certiorari should issue to review the opinion of the California Appellate Court for the Second Appellate District.

Respectfully submitted,

GRAVEN PERRY BLOCK BRODY & QUALLS
a Professional Corporation

By _____
Ralph B. Perry III,
Attorneys for Petitioner
J. Alexander Securities, Inc.

APPENDIX A

OPINION OF THE CALIFORNIA
COURT OF APPEAL FOR THE
SECOND APPELLATE DISTRICT

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION TWO

J. ALEXANDER SECURITIES, INC. Petitioner and Appellant, v. SIGNE MENDEZ, Respondent.	)	B070514 (Super. Ct. No. BS015860) FILED AUG 9, 1993

Appeal from a judgment of the Superior Court of Los Angeles County. Charles C. Lee, Judge. Affirmed.

Graven Perry Block Brody & Qualls, and Ralph B. Perry III, for Petitioner and Appellant.

Ross and Scott, and Diana P. Scott, for Respondent.

J. Alexander Securities, Inc. appeals from the judgment entered against it following the trial court's denial of a motion to correct an arbitration award that included punitive damages. We affirm the judgment.

FACTS & PROCEDURAL HISTORY

In 1980, respondent Signe Mendez, an elderly widow, opened a securities account with appellant J. Alexander Securities, Inc., a brokerage firm in Los Angeles. Respondent executed an agreement regarding payment for securities purchased on her behalf, entitled "Cash Account Agreement." The Cash Account Agreement provided, inter alia, that, "[t]his agreement and its enforcement shall be governed by the laws

of the State of New York . . . . "[1] The Cash Account Agreement also contained a clause providing for arbitration of "any dispute or controversy between [appellant and respondent] arising under any provision of the federal securities laws" and "all other disputes or controversies between us arising out of [appellant's] business or this agreement."[2]

[1] Appellant is a member of the National Association of Securities Dealers which is headquartered in New York. According to appellant, the majority of the trades made on respondent's behalf were executed on the New York Stock Exchange, and all transactions in her account with appellant were cleared through a corporation headquartered in New York.

[2] The arbitration provisions read in full: "ANY DISPUTE OR CONTROVERSY BETWEEN US ARISING UNDER ANY PROVISION OF THE FEDERAL SECURITIES LAWS CAN BE RESOLVED THROUGH LITIGATION IN THE COURTS IF THE UNDERSIGNED SO CHOOSES. THE UNDERSIGNED ALSO UNDERSTANDS THAT ARBITRATION IS AVAILABLE WITH RESPECT TO

In 1991, a dispute arose in which respondent alleged that appellant and Andrew Weber, an account manager employed by appellant, had engaged in securities fraud, deceptive practices, account churning and unauthorized and unsuitable stock trades, resulting in substantial financial losses to respondent. The parties, without objection, submitted their dispute to arbitration before a National Association of Securities Dealers (NASD) panel of three

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SUCH DISPUTES. Additionally, all other disputes or controversies between us arising out of your business or this agreement, shall be submitted to arbitration conducted under the provisions of the Constitution and Rules [of] the Board of Governors of the New York Stock Exchange, Inc., or pursuant to the Code of Arbitration Procedures of the National Association Of Securities Dealers, Inc., as the undersigned may elect. . . ."

arbitrators.[3] In January 1992, hearings on the controversy were conducted before the panel in Los Angeles. It is undisputed that the issue of punitive damages was submitted to the arbitrators.[4] On March 10, 1992, the

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[3] According to appellant, only one of the arbitrators was connected with the securities industry, and the other two were "public" arbitrators, in accordance with NASD rules. The rules provide for selection of the panel by the NASD Director of Arbitration, and the parties then have the opportunity to exercise unlimited challenges for cause and one peremptory challenge.

[4] Respondent requested that we take judicial notice of her statement of claim presented to the panel and appellant's answer. We deferred ruling on this request pending consideration of this appeal. We have granted the request (Jonas v. Kvistad (1971) 19 Cal.App.3d 836, 842; National Automobile & Cas. Ins. Co. v. Payne (1986) 261 Cal.App.2d 403, 408; Code Civ. Proc., § 909) but in doing so, do not purport to review the merits of the arbitrators' decision. (Cf. City of Oakland v. United Public Employees (1986) 179 Cal.App.3d 356, 366, fn. 3.)

panel awarded respondent $27,000 in compensatory damages, for which appellant and Weber were held jointly liable, and $27,000 in punitive damages against appellant only, for the "failure to meet its duty and obligation to adequately supervise Andrew E. Weber, in that it did not come up to the standard of supervision required to assure compliance with applicable securities regulations."

In April 1992, appellant moved to correct the arbitration award pursuant to Code of Civil Procedure section 1286.6, on the ground that the arbitrators had exceeded their powers by awarding punitive damages. It contended that pursuant to the Cash Account Agreement, the arbitrators were bound by New York law, and that New York law prohibits arbitrators from awarding punitive

damages. Respondent opposed the motion on the grounds that (1) the Cash Account Agreement was not the subject of the arbitration, and thus, its provisions did not apply; (2) there was no agreement to apply New York law, and in fact, the arbitrators did not apply New York law; (3) even if there had been an agreement that New York law applied, the matter of punitive damages was a procedural issue, which was governed by NASD rules and California law, and would not be affected by New York law; and (4) the award of punitive damages did not violate due process principles because appellant and Weber knew that respondent was seeking punitive damages, and litigated that issue in the arbitration.

The court denied the motion to correct the award, and confirmed the

award "on the grounds set forth in the opposition papers." Judgment was entered accordingly.

CONTENTIONS ON APPEAL

Appellant contends the trial court erred in denying its motion to correct the award and vacate the punitive damages because (1) the parties never agreed to grant the arbitrators the power to award punitive damages, (2) the arbitrators exceeded their powers by awarding punitive damages since they were bound by New York law, and (3) the award of punitive damages resulted in a denial of due process.

Respondent requests sanctions against appellant for the filing of a frivolous appeal. (Code Civ. Proc., § 907.)

DISCUSSION

Code of Civil Procedure section 1286.6 provides that an arbitration award shall be corrected if "(a) [t]here was an evident miscalculation of figures or an evidence mistake in the description of any person, thing or property referred to in the award; [¶] (b) The arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision upon the controversy submitted; or [¶] (c) The award is imperfect in a matter of form, not affecting the merits of the controversy."

Code of Civil Procedure section 1286.2 provides five specific grounds under which a court can vacate an arbitration award: (1) if the award was procured by corruption, fraud, or other undue means; (2) if any of the

arbitrators was corrupt; (3) if the rights of a party were substantially prejudiced by the misconduct of an arbitrator; (4) if the arbitrators exceeded their powers and the award cannot be correct without affecting the merits of the decision upon the controversy submitted; or (5) the rights of a party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon a showing of sufficient cause, to hear material evidence, or by any other conduct.

These statutes provide the exclusive grounds upon which a court may review private arbitration awards. (Moncharsh v. Heily & Blase (1992) 3 Cal.4th 1, 26-28.) Judicial review of arbitration awards is limited to these specific and narrow statutory grounds, since "by

voluntarily submitting to arbitration, the parties have agreed to bear [the risk of an erroneous decision by the arbitrator] in return for a quick, inexpensive, and conclusive resolution to their dispute." (Id. at pp. 11-12.)

The recently-decided Moncharsh case represents a significant shift in California law towards private dispute resolution. The clear impact of that case is to allow parties the latitude to select their method of dispute resolution and to promote judicial restraint from interfering with that process and the resulting judgment unless there are extremely egregious circumstances surrounding the method of resolution.

Appellant contends that the award must be corrected pursuant to Code of Civil Procedure section 1286.6,

subdivision (b), because the arbitrators exceeded their powers and that the award can be corrected merely by striking the punitive damages portion of the award.

(1) The Arbitrators Did Not Exceed Their Powers in Awarding Punitive Damages

A. The Arbitrators Were Not Precluded From Awarding Punitive Damages by Virtue of the New York Law Provision.

The parties do not dispute that under New York law, arbitrators have no authority to award punitive damages. (Garrity v. Lyle Stuart, Inc. (1976) 40 N.Y.2d 354 [386 N.Y.S.2d 831; 353 N.E.2d 793].) Assuming that the Cash Account Agreement governed the dispute submitted

to arbitration,[5] and that pursuant to it the parties agreed that the arbitrators were to apply New York law in resolving the dispute, the choice of law provision does not compel us to vacate the award of punitive damages.[6]

Because the Cash Account Agreement "evidenced a transaction in interstate commerce," the Federal Arbitration Act (FAA) applies. (9 U.S.C. § 2; Bonar v. Dean Witter Reynolds, Inc. (11th Cir.

[5] Respondent claims that the Cash Account Agreement did not constitute the entire agreement between the parties, and was merely an exhibit introduced at the arbitration proceedings to establish appellant's lack of discretion in stock purchases. However, there is no indication from the record what comprised the "entire agreement" between the parties.

[6] The parties concede that the New York prohibition on punitives was not argued in the arbitration proceedings.

1988) 835 F.2d 1378, 1387; Raytheon Co. v. Automated Business Systems, Inc. (1st Cir. 1989) 882 F.2d 6, 9.) The purpose and effect of the FAA is to encourage arbitration of civil disputes outside the judicial forum. (Southland Corp. v. Keating (1984) 465 U.S. 1, 10-11, [79 L.Ed.2d 1, 13; 104 S.Ct. 852, 859]; Moses H. Cone Hospital v. Mercury Constr. Corp. (1983) 460 U.S. 1, 22 [74 L.Ed.2d 765; 103 S.Ct. 927, 941-942].) The FAA creates a body of federal substantive law which governs the question of arbitrability in both state and federal courts. (Southland Corp. v. Keating, supra, at p. 12; Moses H. Cone Hospital v. Mercury Constr. Corp., supra, at p. 24; Todd Shipyards Corp. v. Cunard Line, Ltd. (9th Cir. 1991) 943 F.2d 1056, 1062.) The overriding principle

underlying the FAA is that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration". (Moses H. Cone Hospital v. Mercury Constr. Corp., supra, at pp. 24-25.) Federal policy supports vesting arbitrators with the authority to award punitive damages if the parties' agreement contemplates such an award. (Todd Shipyards Corp. v. Cunard Line, Ltd., supra, at pp. 1062-63; Bonar v. Dean Witter Reynolds, Inc., supra, at p. 1387; Raytheon Co. v. Automated Business Systems, Inc., supra, at pp. 11-12; Willoughby Roofing & Supply v. Kajima Intern. (N.D. Ala. 1984) 598 F.Supp. 353, 360, aff'd in (11th Cir. 1985) 776 F.2d

269.)[7] The choice of law provision, therefore, merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages. (Bonar v. Dean Witter Reynolds, Inc., supra, at p. 1387; Willoughby Roofing & Supply v. Kajima, Intern., supra, at p. 359, Raytheon Co. v. Automated Business Systems, Inc., supra, at p. 11, fn. 5, Willis v.

[7] We decline to follow two Second Circuit cases, Barbier v. Shearson Lehman Hutton Inc. (2nd Cir. 1991) 948 F.2d 117, 122 and Fahnestock & Co. v. Waltman (2nd Cir. 1991) 935 F.2d 512, 518, which held, contrary to the cases cited above, that state law relating to the propriety of a punitive damages award by an arbitrator is not preempted by federal substantive law, and thus vacated the punitive damage awards. (See further discussion of these cases, infra.)

Shearson/American Express, Inc. (M.D. N.C. 1983) 569 F.Supp. 821, 824; Singer v. E.F. Hutton & Co., Inc. (S.D. Fla. 1988) 699 F.Supp. 276, 279.)

B. The Agreement Contemplated the Award of Punitive Damages.

Appellant contends that even apart from the choice of law provision, there was nothing in the parties' agreement which indicated that punitive damages were contemplated. A review of the Cash Account Agreement reveals that appellant is correct; there is nothing contained therein which either expressly includes or excludes awards of punitive damages.

It is undisputed that the agreement of the parties controls the scope of the arbitrators' authority. (See United Steelworkers v. Enterprise Corp. (4th

Cir. 1960) 363 U.S. 593, 597; Totem Marine Tug & Barge v. North Am. Towing, Inc. (5th Cir. 1979) 607 F.2d 649, 651.) Here, the agreement to arbitrate contained in the Cash Account Agreement encompassed "any dispute or controversy between [the parties] arising under any provision of the Federal securities laws" and "all other disputes or controversies between [the parties] arising out of [appellant's] business or this agreement." These clauses clearly seem to contemplate a wide range of tort and contract claims. Moreover, clauses similar to these have been held sufficiently broad to encompass awards of punitive damages. (See e.g., Raytheon Co. v. Automated Business Systems, Inc., supra, 882 F.2d at pp. 7, 10-12 ["[a]ll disputes arising in connection with the

Agreement shall be settled by arbitration . . . ."]; Willoughby Roofing & Supply v. Kajima Intern., supra, at pp. 355, 358 ["[a]ll claims, disputes, and other matters in question arising out of, or relating to, this Agreement or Work Assignment or the breach thereof . . . shall be resolved by arbitration . . . ."]; Willis v. Shearson/American Express, Inc., supra, at pp. 822-823 ["any controversy arising out of or relating to my accounts, the transactions with you or me or to this agreement or the breach thereof, shall be settled by arbitration . . . ."].) We likewise hold that the arbitration provisions in the Cash Account Agreement contemplated punitive damages.

Appellant further argues that because the Cash Account Agreement also

provides that the arbitration be conducted in accordance with New York Stock Exchange (NYSE) Rules or the Code of Arbitration Procedures of the NASD, which are silent on the issue of punitive damages, such an award was not contemplated by the parties. Appellant distinguishes Todd Shipyards Corp. v. Cunard Line, Ltd., supra, 943 F.2d 1056 and Bonar v. Dean Witter Reynolds, Inc., supra, 835 F.2d 1378, cases which upheld punitive damage awards by arbitrators despite New York choice of law provisions, on the grounds that those cases involved arbitration agreements which incorporated the rules of the American Arbitration Association (AAA) instead of NASD rules. The AAA rules provide that the arbitrator may "grant any remedy or relief which is just and

equitable and within the terms of the agreement of the parties." (Emphasis added.) Appellant contends that because this arbitration was conducted under the auspices of the NYSE and NASD and not pursuant to the AAA, an award of punitive damages was not contemplated by the agreement, citing Fahnestock and Co., Inc. v. Waltman, supra, 935 F.2d 512.

In Fahnestock, the arbitration agreement incorporated the NYSE arbitration rules which do not have any provisions relating to remedies or relief. The Second Circuit held that those rules did not contemplate punitive damage awards despite the fact that the NYSE award form contains a specific

section for punitives.[8] We do not find, given the overwhelming policy favoring arbitrability enunciated by other federal circuits, that the NASD's failure to specifically address the issue of damages in its arbitration rules manual expressly precluded the arbitrators here from awarding punitive damages. (See Shearson/American Express, Inc. v. McMahon (1987) 482 U.S. 220 [107 S.Ct. 2332, 96 L.Ed.2d 185], holding that RICO claims, including those seeking treble

[8] The court in Fahnestock, however, noted that while no choice of law provision was contained in the agreement to arbitrate, New York law applied because diversity was the basis for subject matter jurisdiction, and that "NYSE arbitrations occur throughout the nation, and our holding here does not mean that in those states in which arbitral punitive damages awards are permitted, arbitrators may not appropriately utilize the punitive damages section of the award form." (Id. at p. 519.)

damage awards, are arbitrable under the FAA.)

Another Second Circuit case, Barbier v. Shearson Lehman Hutton Inc., supra, 948 F.2d 117, reversed an order confirming a punitive damages award despite a New York choice of law provision in the parties' agreement to arbitrate. The court found that the measure of damages is a matter of state substantive law and that the choice of law provision reflected the agreement and the intention of the parties, and thus, it was merely enforcing the terms of their agreement by voiding the punitive damage award. (Id. at p. 122.)

The results in Fahnestock and Barbier are in direct contravention to the prevailing policy in California. Two California cases have dealt squarely with

the issue of an arbitrator's authority to award punitive damages. In Baker v. Sadick (1984) 162 Cal.App.3d 618, a patient about to undergo surgery signed an agreement which provided that "any dispute as to medical malpractice . . . will be determined by submission to arbitration." A panel of arbitrators awarded the patient punitive damages in conjunction with her medical malpractice claim. On appeal from an order confirming that portion of the award, the Fourth District found, inter alia, that the agreement did not preclude a punitive damage award since the parties did not have a "plain and clear" mutual understanding that punitive damages would not be awarded, and that state public policy favored arbitration of medical malpractice claims. (Id. at pp. 626,

630.) In a later decision, Tate v. Saratoga Savings & Loan Assn. (1989) 216 Cal.App.3d 843, an appeals court found that while an arbitration clause which provided for arbitration of "any controversy aris[ing] between the parties concerning this Joint Venture, construction of said project, or the rights and duties of any party under this Agreement," did not specifically allow for punitive damages, it was not irrational to conclude that the parties contemplated the possibility of punitive damages and that the arbitrators did not act in excess of their powers in awarding punitives. (Id. at p. 855.) Based on the absence of any express clause in the Cash Account Agreement or in the NASD rules prohibiting an award of punitive damages, we cannot say the arbitrators

acted in excess of their powers.

Furthermore, any suggestion that respondent waived her right to punitive damages by signing the Cash Account Agreement is wholly without merit. Respondent was obviously required to sign the document as a prerequisite to doing business with appellant and it is doubtful she had the opportunity to negotiate any of its terms. The Cash Account Agreement does not explicitly address the issue of punitives, nor should respondent, a consumer residing in Los Angeles, have been expected to know the applicable provisions of New York law or the NASD rules concerning punitive damages.[9] Without a voluntary and

[9] Indeed, appellant contended in both the trial court and on appeal, that the sole reason for incorporating a New York law provision was to preclude punitive

intentional relinquishment of a known right, respondent cannot be deemed to have waived her right to punitive damages. (Bonar v. Dean Witter Reynolds, Inc., supra, 835 F.2d at pp. 1387-1388; Raytheon Co. v. Automated Business Systems, Inc., supra, 882 F.2d at pp. 11-12.)

Moreover, it is a standard principle of contract interpretation that ambiguities be resolved against the drafter. (Steven v. Fidelity & Casualty Co. (1962) 58 Cal.2d 862, 882-884; see Rest. 2d Contracts (1981) § 206 pp. 105-106; 4 Williston on Contracts (3d ed. 1961) § 621, pp. 760-774.) Appellant drafted the Cash Account Agreement and

damage awards. It, however, did not see fit to spell out that reason in plain language in the Cash Account Agreement, but instead disguised it.

was perfectly capable of including an express exclusion of the availability of punitive damages but did not do so. (Raytheon, supra, at p. 12.) In the absence of an express exclusion, however, we will not automatically assign such a prohibition to their agreement. (Willoughby Roofing & Supply v. Kajima Intern., supra, 598 F.Supp. 353, 358; Ehrich v. A.G. Edwards & Sons, Inc. (D. S.D. 1987) 675 F.Supp. 559, 564; Baker v. Sadick, supra, 162 Cal.App.3d 618, 626.)

In view of our holding, we need not reach the question as to whether the award can be corrected by simply striking the punitive damage portion.

(2) Appellant Was Not Deprived of Due Process

Appellant contends the absence of constraints upon arbitrators in awarding

punitive damages and lack of judicial review result in a denial of its due process rights, citing Pacific Mut. Life Ins. Co. v. Haslip (1991) 499 U.S. 1 [113 L.Ed.2d 1; 111 S.Ct. 1032]. In Haslip, the Supreme Court addressed the constitutionality of jury-awarded punitive damages which were four times the amount of the compensatory damages. The award was upheld after the Supreme Court found that the record supported the award, and that the procedural safeguards employed by the Alabama trial and appellate courts did not violate due process principles.

Appellant claims that because there were no "meaningful constraints" upon the arbitrators nor sufficient facts to support the award, the arbitrators' award of punitive damages was arbitrary and

capricious. A similar argument was rejected by the Ninth Circuit in Todd Shipyards Corp. v. Cunard Line, Ltd., supra, 943 F.2d at p. 1063, decided approximately five months after Haslip, where the court found that the award did not result in a denial of due process to appellant since it had notice that respondent sought punitive damages, and was given the opportunity to present evidence, to argue the merits of its position, and to challenge the arbitrator's award. (Todd Shipyards Corp. v. Cunard Line, Ltd., supra, 943 F.2d at pp. 1063-1064; Raytheon Co. v. Automated Business Systems, Inc., supra, 882 F.2d at pp. 8-9.) Here appellant has not alleged any facts which would support its contention that the arbitrators acted arbitrarily and capriciously, facts which

would entitle it to move to vacate the award pursuant to Code of Civil Procedure section 1286.2, subdivisions (a), (b), (c), or (e). Appellant does not claim that it did not have notice of respondent's claim for punitive damages, nor that it was precluded from presenting any evidence or legal theories militating against such award. Moreover, the dispute was presented to a panel of three arbitrators, selected by the parties, which was much less likely than a jury to be swayed by passion and prejudice. (See Willoughby Roofing & Supply v. Kajima Intern., supra, 598 F.Supp. 353, 358, 363 ["Indeed, an arbitrator steeped in the practice of a given trade is often better equipped than a judge not only to decide what behavior so transgresses the limits of acceptable commercial practice in that

trade as to warrant a punitive award, but also to determine the amount of punitive damages needed to (1) adequately deter others in the trade from engaging in similar misconduct, and (2) punish the particular defendant in accordance with the magnitude of his misdeed. See generally, Note, Punitive Damages in Arbitration: The Search for a Workable Rule, 63 Cornell L.Rev. 272 (1978)."] We therefore find no violation of its due process rights.

California has already addressed the issue of the lack of judicial review of punitive damage arbitration awards in Baker v. Sadick, supra, 162 Cal.App.3d 618, 630. That opinion stated: "Finally, we are not persuaded by the argument if an arbitrator is permitted to award punitive damages in medical

malpractice claims submitted to arbitration agreements to arbitrate will be discouraged because punitive damages awards are not reviewable. A holding [that] punitive damages may be awarded in arbitration of a medical malpractice claim required to be submitted to arbitration by an arbitration agreement as broad as the one here involved does not divest the parties of their power to control the scope of arbitration by the terms of their agreement." (Ibid.) We find nothing in Haslip that warrants alteration of this policy.

In light of the overwhelming policy arguments favoring arbitration as an alternative dispute resolution forum, as enunciated in Moncharsh v. Heily & Blase, supra, 3 Cal.4th 1, we see no reason to limit those awards where parties have

agreed to resolve their disputes outside the judicial forum.

(3) Respondent's Request for Sanctions is Denied

Respondent requests attorney's fees and penalties on the grounds that the appeal is frivolous. Although we have determined that the appeal is not meritorious, we do not conclude that it was frivolous. We therefore deny respondent's request.

DISPOSITION

The judgment confirming the arbitration award is affirmed. Respondent is awarded her costs on appeal.

CERTIFIED FOR PUBLICATION.

/s/ Nott, J.

We concur:

/s/ Gates, Acting P.J.
GATES

/s/ Fukuto, J.
FUKUTO

APPENDIX B

DENIAL OF
DISCRETIONARY REVIEW
BY THE CALIFORNIA SUPREME COURT

Second Appellate District,
Division Two, No. B070514
S035102

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

IN BANK

SUPREME COURT
FILED NOV. 24, 1993

J. ALEXANDER SECURITIES INC., Appellant

v.

SIGNE MENDEZ, Respondent

Petition for review DENIED.

Mosk, J. and Kennard, J. are of the opinion the petition should be granted.

The request for an order directing depublication of the opinion is denied.

Arabian
Acting Chief Justice

APPENDIX C

CONSTITUTIONAL PROVISIONS,
STATUTES AND RULES INVOLVED

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

1. Constitution of the United States. The Fourteenth Amendment provides in relevant part:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law; not deny to any person within its jurisdiction the equal protection of the laws.

2. Federal Statute. Section 4 of the Federal Arbitration Act, July 30, 1947, C. 392, 61 Stat. 669, amended September 3, 1954, C. 1293, 68 Stat. 1233, codified at 9 U.S.C. § 4, provides in part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate

under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.

3. California Statutes. Sections 1285 and 1286.6 of the California Code of Civil Procedure:

CCP §1285 provides in pertinent part:

> Any party to an arbitration in which an award

> has been made may petition the court to confirm, correct, or vacate the award.

CCP §1286.6 then specifies the grounds for correction of an award, stating the court:

> shall correct the award and confirm it as corrected if the court determines that: . . .
> (b) the arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision upon the controversy submitted. . .

4. NASD Code of Arbitration Procedure.

Section 19:

> (b) In arbitration matters involving public customers and where the amount in controversy

exceeds $30,000 . . . the Director of Arbitration shall appoint an arbitration panel which consists of no fewer than three (3) nor more than five (5) arbitrators, at least a majority of whom shall not be from the securities industry, unless the public customer requests a panel consisting of at least a majority from the securities industry.

No. 93-1338

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

vs.

SIGNE MENDEZ,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

WHETHER ARBITRATORS ARE PRECLUDED FROM AWARDING PUNITIVE DAMAGES WHEN THE PARTIES' SUBMISSION AGREEMENT, ALTHOUGH NOT SPECIFICALLY PROVIDING FOR PUNITIVE DAMAGES, INCORPORATES THE CLAIMANT'S DAMAGES CLAIM WHICH SPECIFICALLY SEEKS PUNITIVES, AND PETITIONER FAILS TO OBJECT TO THEIR CONSIDERATION.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Federal Statutes

State Statutes

Rules

No. 93-1338

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

vs.

SIGNE MENDEZ,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION

Respondent Signe Mendez respectfully prays that Petitioner J. Alexander Securities, Inc.'s Petition for Writ of Certiorari be denied.

STATUTES AND REGULATIONS INVOLVED

1. Federal Statute

   9 U.S.C. §4

2. California Statutes

   Code of Civil Procedure

   §632
   §1286.6

3. NASD Code of Arbitration Procedure

STATEMENT OF THE CASE

The documents through which Respondent Signe Mendez originally opened her account with Petitioner J. Alexander Securities ("Petitioner") are not part of the record. However, submitted at the time of the arbitration as a document confirming Respondent did not have a discretionary account was one of the only documents bearing her signature, entitled "Cash Account Agreement," which provided that, in the event the client could not pay for

any particular trade, her account could be liquidated, i.e., "cashed out." (C8, pp. 164-165.) The document had nothing to do with the claims before the arbitration panel, which sought recovery for securities fraud, deceptive practices, account churning and inappropriate and unauthorized trades. The relevance of the "Cash Account Agreement" was established, as a matter of law at the Superior Court level [Beckett v. Kaynar Mfg. Co., Inc. (1958) 49 Cal.2d 695, 699] in a declaration by Petitioner's counsel, as confirming solely that Respondent did not sign a discretionary account form. (C8, pp. 164-165.) This document had nothing to do with the parties' choice of law at the arbitration, and may not be used now as a matter of law to establish choice of law.

Respondent amended her original claim solely at the request of Petitioner who sought more detail. The amended claim spelled out the specific dollar amounts sought and a request for attorneys' fees and punitive damages. (Court of Appeals Decision, Appendix, A5, fn. 4.) Petitioner's answer to the claim specifically acknowledged punitive damages were sought, and did nothing to contest the arbitrators' jurisdiction at this time over such damages. (Appendix, A5.) Rather, it merely argued throughout pursuant to California law that the facts did not support such damages. (Appendix, A5.)

The arbitration award granting punitive damages did so against the brokerage personally for its own "failure to meet its duty and obligation to adequately supervise [broker] Andrew E.

Webber, in that it did not come up to the standard of supervision required to assure compliance with applicable securities regulations." (Appendix, A6.) Punitive damages were not awarded based on vicarious liability or ratification of the broker's own acts and omissions.

The Petition to Correct filed before the Los Angeles County Superior Court sought to eviscerate the punitive damage award (while attempting to maintain both the compensatory damages which were substantially below what Respondent sought as well as the refusal to award attorneys' fees) by claiming the award of punitive damages violated Petitioner's right to due process. Petitioner also claimed that New York law applied, which barred an award of punitive damages. (Appendix, A6.) Because Petitioner sought to correct only part of the award, it was apparently

conceding that it received due process with respect to the compensatory damages and attorneys' fees, hence claiming that the three-person arbitration panel exercised two different due process standards. However, the Superior Court upheld the arbitration award; there was no statement of decision because Petitioner failed to request one timely. Code of Civ. Proc. §632.

Petitioner then appealed to the California Court of Appeals, Second Appellate District which, in a well-reasoned decision, affirmed the Superior Court decision. Pacific Mutual v. Haslip (1991) 499 U.S. 1, 111 S.Ct. 1032, 113 L.Ed.2d 1, was not given "short shrift" by the California appellate court; rather, it correctly held that Haslip did not control the analysis of the issues before it.

SUMMARY OF ARGUMENT

1. This case presents no issue appropriate for the Court's exercise of its discretionary jurisdiction. The underlying final and binding arbitration was tried pursuant to California law under which, in the absence of fraud, it is not reviewable as a matter of law or equity. California law further provides that punitive damages may be awarded when sought by the claimant if not expressly excluded. Such damages were specifically sought, fully litigated, and awarded under California law.

2. The court's opinion in Pacific Mutual v. Haslip does not raise due process considerations which are relevant to a binding securities arbitration. Nor does Haslip in any way deny arbitrators the authority to award punitive damages.

3. California law, not that of New York, was always the controlling law in this matter. Even, however, in the presence of New York law, California has already adopted the distinction between following the procedural versus substantive law of New York, which rule does not "ignore" the parties' choice of law and, further, is based on California's own pronounced public policy.

REASONS WHY THE WRIT SHOULD BE DENIED

I. THE ARBITRATION DECISION IS NOT, IN THE FIRST INSTANCE, REVIEWABLE AS A MATTER OF LAW OR EQUITY

The fatal flaw in Petitioner's entire argument is its attempt unilaterally to eviscerate a portion of a binding and final arbitration award after having full notice from the outset that the damages

sought by Respondent and considered by the arbitrators included punitive damages. Judicial review of this decision is limited to those specific and narrow statutory grounds set forth in Code of Civ. Proc. §1286.6, since "by voluntarily submitting to arbitration, the parties have agreed to bear [the risk of an erroneous decision by the arbitrator] in return for a quick, inexpensive and conclusive resolution to their dispute." Moncharsh v. Heily & Blase (1992) 3 Cal.4th 1, 11-12.

It is disingenuous at best to give any credence to the assertion that the only party which, in a securities arbitration, would be guilty of conduct warranting punitive damages must give its consent, in the true sense of "permission," to validate such an award. Indeed, carried to its logical conclusion,

such a holding could entitle the brokerage to "consent" only to damages below a certain dollar amount or to withhold "consent" to other basic rights held by a securities customer to be made whole, resulting in a brokerage-controlled sham proceeding which is anything but "alternative dispute resolution". Rather, "consent" in this context is logically determined by what has been submitted for consideration by either party to the arbitrators as defined by the scope of the dispute (i.e., here, the parties' relationship as brokerage/client). Such an interpretation is upheld by the California Supreme Court in Moncharsh, supra, 3 Cal.App.4th at 28: "It is within the 'powers' of the arbitrator to resolve the entire 'merits' of the 'controversy submitted' by the parties . . . (Section 1286.6 subd. (b)(c).) Obviously, the

'merits' include all the contested issues of law and fact submitted to the arbitrator for decision. The arbitrator's resolution of these issues is what the parties bargain for in the agreement." The record confirms through the appellate court's judicial notice of the underlying arbitration pleadings that the issue of punitive damages was clearly before them. The fact that punitive damages were "contested" as specifically envisioned by Moncharsh does not remove them from the scope of the issues before the arbitration panel[1].

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[1] Consistent by distinction with this analysis is the case cited by Petitioner of Thompson v. Jesperson (1990) 222 Cal.App.3d 964, in which attorneys' fees were voluntarily and unilaterally awarded to one side by the arbitrators, and were disallowed by the superior court because neither party had submitted argument thereon or otherwise contemplated that issue as part of the scope of their dispute.

From an equitable perspective, Petitioner has failed at all three appellate reviews of this intended "binding and final" arbitration award to explain why it failed to object to punitive damages, and/or raise New York law, in the underlying arbitration, thereby affording both parties the opportunity to brief the issue of the inclusion of punitive damages for the arbitrators up front. It is sheer speculation now to argue that the existing amount of the compensatory award[2], and/or the denial of attorneys' fees, would have remained so had the arbitrators known their award would be cut in half by a

[2] Note that the $27,000.00 compensatory damage award was far below the actual relief requested: See Award, C1, p. 16: RELIEF REQUESTED. Claimant Requested: Compensatory damages in the amount of $111,170.04, punitive damages and attorneys fees."

brokerage "lying in the grass" with questionable defenses asserted as sheer afterthought. Hence, it is neither legally permissible nor procedurally equitable to "rewrite" the arbitration award when Petitioner has otherwise failed to allege fraud by the parties or dishonesty by the arbitrator. United Paper Workers Intl. Union, AFL-CIO, et al. v. Misco, Inc., (1987) 484 U.S. 29, 98 L.Ed.2d 286, 298.

II. HASLIP DUE PROCESS CONSIDERATIONS ARE NOT INVOKED THROUGH A SECURITIES ARBITRATION

Appellant misconstrues the recent burst of attention on the viability of punitive damages in jury trials as an excuse to avoid its problematic waiver of the New York law issue, relying on the Haslip opinion in claiming its "due

process" right was violated through award of punitive damages and that such a constitutional right can never be waived. Yet the law is clear that all defenses in an arbitration must be affirmatively raised or be lost. Beckett v. Kaynar Mfg. Co., Inc. (1958) 49 Cal.2d 695, 699-700; O'Malley v. Petroleum Maintenance Co. (1957) 48 Cal.2d 107, 110; Hydrothermal Energy Corp. v. Fort Bidwell Indian Community Council (1985) 170 Cal.App.3d 489, 497. In the present matter the alleged violation of due process did not arise after the fact from the award itself, but rather was ascertainable from the outset by the very submission and consideration of punitive damages as a remedy. Hence, waiver in this matter cannot be pushed aside as a mere procedural defense dwarfed by the constitutional proportions of due process.

As stated by the court in Todd Shipyard Corp. v. Cunard Line, Ltd. (9th Cir. 1991) 943 F.2d 1056, which rejected the losing party's claim that an award of punitive damages violated its due process:

> Cunard had every opportunity to present evidence, to argue the merits of its position, and to challenge the arbitrator's award of court. Having taken advantage of this process, into which it entered voluntarily, Cunard cannot now argue that its due process was denied. (943 F.2d at 1064.)

Haslip has no application to alternative dispute resolution, which is bottomed on entirely different public policy considerations than were invoked through the Alabama statutes analyzed in Haslip. Note that California has already passed upon and upheld the constitutionality of its punitive damage

provisions post-Haslip in Las Palmas Assocs. v. Las Palmas Center Assocs. (1991) 235 Cal.App.3d 1220, 1256-1259.

The only case even remotely on point with the matter before this Honorable Court is Lee v. Chica, 983 F.2d 883, petition for rehearing and rehearing in banc denied, March 4, 1993, cert. denied, 114 S.Ct. 287 (1993). In Lee, the majority began by observing that judicial review of arbitration awards is narrowly limited and an arbitration award will not be set aside unless it is completely irrational or evidences a "manifest disregard for law." (Id. at 885.) Concerning punitive damages, the claimant argued on appeal that the district court erred in disallowing punitive damages because American Arbitration Association rules (which controlled in that securities arbitration) allowed arbitration panels to

award punitive damages and because federal courts have upheld arbitral awards of punitive damages. The appeals court majority sided with the claimant and concluded essentially that because some circuits have held (and the majority agreed) that "AAA arbitrators may grant any remedy or relief including punitive damages", and because AAA Rule 43 specifically allows arbitrators to award "any remedy or relief that the arbitrator deems just and equitable," the district court had erred in vacating the punitive damage award. (Id. at 887.)

Note that in Lee v. Chica, the respondent argued that the law of Minnesota, where the arbitration occurred, prohibited an award of punitive damages by an arbitration panel and that the arbitration clause in the customer agreement incorporated Minnesota law as

the law governing the contract. While the National Association of Securities Dealers ("NASD") Code of Arbitration Procedure, which governs the within arbitration, is not per se as broadly worded as AAA Rule 43, the submission to arbitration [C8, pp. 156-158] clearly makes no reference to excluding punitive damages or to application of New York law, and in fact provided at ¶1 thereof that the parties "hereby submit the present matter in controversy as set forth in the attached statement of claim, answer, cross-claims and all related counter-claims and/or third party claims as may be asserted, to arbitration in accordance with the Constitution, By Laws, Rules, Regulations and/or Code of Arbitration Procedure of the sponsoring organization." The NASD rules do not in any way limit the remedies available or the scope of the arbitrators'

powers and, in fact, refer to "novel theories" of remedies in connection with presentation of trial briefs. (C9:192-211 at 208.)

Further, in the present matter it is clear that California law does not in any way (unlike that of Minnesota) limit the availability of punitive damages. Indeed, Moncharsh confirms that "[a]rbitrators, unless specifically required to act in conformity with rules of law, may base their decision upon broad principles of justice and equity, and in doing so may expressly or impliedly reject a claim that a party might successfully have asserted in a judicial action. (Citations omitted.)" Id. at 10. Further, "the arbitrators are not bound to award on principles of dry law, but may decide on principles of equity and good conscience, and may make their awards ex aequo et bono

[according to what is just and good]. (Citations omitted.)" Id. at pp. 10-11. Importantly, California law specifically entitles arbitrators to award punitive damages as long as they are not expressly excluded. Tate v. Saratoga Savings & Loan Assn., (1989) 216 Cal.App.3d 843, 855; see also, Baker v. Sadick (1984) 162 Cal.App.3d 618, 626, 630.

While Petitioner claims that Lee v. Chica is distinguishable in that it failed to analyze the due process ramifications enunciated in Haslip, the Haslip opinion is in fact not applicable to alternative dispute resolution. Since the Haslip opinion concludes that punitive damages are not per se unconstitutional in the jury trial context, it seems probable that the Supreme Court would likewise conclude that punitive damages are not per se unconstitutional in the contractual

arbitration context, although the Supreme Court has never addressed the issue except, by analogy, in approving arbitration of treble damages in anti-trust and RICO[3] cases. See, Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, (1985) 473 U.S. 638, 105 S.Ct. 3346, 3358, 87 L.Ed.2d 444; Shearson Amer. Express v. McMahon, (1987) 482 U.S. 220, 107 S.Ct. 2332, 2344, 96 L.Ed.2d 185. Hence, the dissent in Lee v. Chica on which Petitioner relies finds no apparent support in Haslip for its argument that arbitrators should be flatly denied any authority to impose punitive damages on constitutional grounds. (Id. at 889.)

Nor similarly is there any language in Haslip directly addressing whether the

[3] RICO claims are based on the Racketeer Influenced Corrupt Organizations Act, 18 U.S.C. §§1961, et seq.

limited scope of discovery before arbitrations or loose application of rules of evidence in arbitrations has any relevance to the constitutionality of punitive damage awards in arbitration cases. Hence, the dissent in Lee v. Chica once again flounders in citing Haslip for its argument that punitive damages should not be allowed in arbitrations because of limited discovery and/or loose applications of rules of evidence in arbitrations.

As in Lee v. Chica, the matter before this court is strictly one of private contract and agreement between the parties, limited only by: (1) the submission to arbitrate (C8, pp. 166-168, which was not the Cash Account agreement); (2) the NASD rules under which the arbitration was held; and (3) the procedural law of the State of California,

none of which excludes punitive damages. Further, federal policy, invoked through application of the Federal Arbitration Act [9 U.S.C. §2], supports vesting arbitrators with the authority to award punitive damages if the parties' agreement contemplates such an award. Todd Shipyards Corp., supra, 943 F.2d at 1062-63; Bonar v. Dean Witter Reynolds, Inc. (11th Cir. 1988) 835 F.2d 1978, 1987; Raytheon Co. v. Automated Business Systems, Inc., (1st Cir. 1989) 882 F.2d 6, 11-12; Willoughby Roofing & Supply v. Kajima Intern. (N.D. Ala. 1984) 598 F.Supp. 353, 360, aff'd in (11th Cir. 1985) 776 F.2d 269.

III. APPELLANT IS ATTEMPTING TO FOIST NEW YORK LAW UPON CALIFORNIA AND OVERRULE WITHOUT AUTHORITY CALIFORNIA'S PRONOUNCEMENT ON CHOICE OF LAW PROVISIONS

The appellate opinion correctly noted at p. A13, fn. 6, that "[t]he parties concede that the New York prohibition on punitives was not argued in the arbitration proceedings." However, California has already mandated that, even in the presence of New York law, there would be no change in the outcome of this arbitration, as California will follow only the substantive law of New York and not its procedural restrictions on arbitrations. Bonar, supra, 835 F.2d at 1987; Willoughby Roofing & Supply, supra, 598 F.2d at 359; Raytheon Co., supra, 882 F.2d at 11, fn. 5; Willis v. Shearson/American Express, Inc. (M.D. N.C. 1983) 569 F.Supp. 821, 824; Singer v. E.F. Hutton & Co., Inc. (S.D. Fla. 1988) 699 F.Supp. 276, 279.[4] Appellant cites absolutely no authority requiring the rest of the United States to follow a single 20-year old opinion out of New York in the face of the issue's previous consideration and rejection as part of California's overall philosophy of alternative dispute resolution through arbitration.

The preprinted, unilaterally presented Cash Account agreement between the parties, the language over which the complaining Petitioner had complete and

[4] The California appellate court declined to follow two Second Circuit cases, Barbier v. Shearson Lehman Hutton, Inc. (2nd Cir. 1991) 948 F.2d 117, 122 and Fahnestock & Co. v. Waltman (2nd Cir. 1991) 935 F.2d 512, 518, which held, contrary to the cases cited above, that state law relating to the propriety of a punitive damages award by an arbitrator is not preempted by federal substantive law, and thus vacated the punitive damage awards.

total control, did not preclude punitive damages: If its innocuous reference to "New York law" was intended as a devious remedy limitation, it was apparently unaware that California had already rejected such sly tactics in adhering under these circumstances to New York substantive law only.

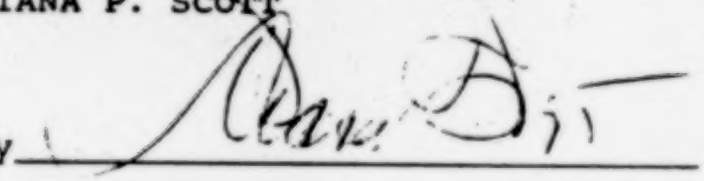
CONCLUSION

The arbitration award in this matter is final and binding and should not be the subject of a third appellate review. New York law did not apply herein and, even if it did, it was only the substantive and not procedure law thereof, which does not preclude punitive damages. Lastly, the Haslip decision is not controlling in this matter and does not invoke procedural due process considerations. The opinion of the California Court of Appeals for the

Second Appellate District should therefore be affirmed.

Respectfully submitted,

ROSS & SCOTT
A Professional Corporation
DIANA P. SCOTT

By 

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SIGNE MENDEZ

(3)

No. 93-1338

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

vs.

SIGNE MENDEZ,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL FOR THE SECOND APPELLATE DISTRICT

REPLY BRIEF TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Rules

NO. 93-1338

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

v.

SIGNE MENDEZ,

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PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL FOR THE SECOND APPELLATE DISTRICT

REPLY BRIEF TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

REPLY BRIEF TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

RESPONDENT IGNORES THE SIMPLE FACT THAT THE CASH ACCOUNT AGREEMENT WAS THE CONTRACT BETWEEN THE CUSTOMER AND THE FIRM AND IT UNEQUIVOCALLY PROVIDED FOR ARBITRATION AND THE APPLICATION OF NEW YORK LAW.

A copy of the "Cash Account Agreement" was introduced at the arbitration by Respondent and was included in the record on appeal in California (C8 pp. 164-165). Respondent was not on margin and this was the only signed agreement she had with the firm.[1]

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[1] As noted in the Petition for Writ of Certiorari, most brokerage firms have arbitration provisions in margin

The agreement expressly provided for arbitration and for the application of New York law and was referred to, and quoted from, extensively by the California Appellate Court. See Petition, App. A2-4. The NASD Code of Arbitration Procedure requires that any controversy be submitted to arbitration "as provided by any duly executed and enforceable written agreement or upon demand of the customer."[2] When the matter was originally submitted to arbitration before the NASD, Respondent's

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agreements but many do not have such provisions in cash account agreements. See Petition, p. 26, n. 13.

[2] Thus, even without an agreement, the customer can require the firm to arbitrate; but not vice versa.

claim did not even include a request for punitive damages.[3]

PETITIONER MADE NO EXPRESS OR KNOWING WAIVER OF ANY CONSTITUTIONAL RIGHTS.

Respondent argues that because punitive damages were claimed, as well as compensatory damages, and all controversies were submitted to arbitration (without the express invocation of Haslip), that the arbitrators' award cannot now be challenged and any rights are waived. But nothing in the submission of the

---

[3] Petitioner did not really have a choice about whether to submit to arbitration if the customer demands it (see NASD Sec. 12(a); C9 p. 196), but nothing in the submission specifically focuses on remedies and no mention whatever is made of punitive damages.

matter or the arbitrators acting on the punitive damage request is sufficient to constitute a waiver of constitutional rights under Haslip. The "implied acquiescence" rule applied by a California appellate court to affirm an award of punitive damages in Baker v. Sadick, 162 Cal.App.3d 618, 626, 208 Cal.Rptr. 676, 681 (1984) is a lesser standard and cannot be invoked to infer waiver of a constitutional right. Fuentes v. Shavin, 407 U.S. 64, 94 n. 31, 92 S.Ct. 1983, 2001 n. 31, 32 L.Ed.2d 556 (1972). The waiver must be a knowing one and not merely the failure to assert it. Bueno v. City of Donna, 714 F.2d 484, 493 (5th Cir. 1983).[4]

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[4] Considering the chances very unlikely that punitive damages would be

Respondent expressly asserts in the Brief in Opposition that the award "in the absence of fraud, . . . is not reviewable as a matter of law or equity." Brief in Opposition, p. 7. This very assertion illustrates how Haslip's due process concern about the unbridled and unreviewable imposition of punitive damages, applies with even greater force in the arbitration setting. The basis for the Garrity rule was the very same concern for the potential arbitrary and penal power implicit in any award of punitive damages, which award, by its

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awarded against Petitioner, no effort was made to argue Garrity or Haslip to the arbitrators. Even under California law no punitive damages could have been awarded in this case by a California court where there was never any evidence of the defendant's net worth. Adams v. Murakami, 54 Cal.3d 105, 284 Cal.Rptr. 318 (1991).

nature, requires "rather close judicial supervision." See Petition for Writ of Certiorari, p. 33.

RESPONDENT CONFUSES SUBSTANTIVE AND PROCEDURAL DUE PROCESS RIGHTS; HASLIP IDENTIFIED A PROCEDURAL DUE PROCESS RIGHT WHICH CANNOT BE WAIVED BY IMPLICATION.

Respondent erroneously characterizes New York's Garrity rule as to the availability of the remedy of punitive damages as "procedural restrictions on arbitrations" and not part of the substantive law of New York. Respondent's Brief in Opposition, p. 24. Respondent goes on to assert, without citation to any California authority, that California would not follow such "procedural restrictions." Ibid.

Citing this Court's decision in

Browning-Ferris Inc. v. Kelco Disposal, Inc., 492 U.S. 257, 278, 109 S.Ct. 2909, 2922, 106 L.Ed.2d 219 (1989), the Second Circuit noted:

> "The measure of damages in general is a matter controlled by New York substantive law where federal jurisdiction in New York is predicated on the diversity of the parties. [citations] It follows that the Garrity rule prohibiting the award of punitive damages by arbitration must be applied. That the rule is grounded in state policy concerns renders it no less a rule of substantive law." Fahnestock & Co., Inc. v. Waltman, 935 F.2d 512, 518 (2nd Cir. 1991).

The right to punitive damages is certainly no less a rule of substantive law where New York state law is applicable by agreement, as opposed to diversity jurisdiction.

The right of due process identified in Haslip is based on the fundamental notion that any delegation of power to award punitive damages to an unrestrained decision-maker violates due process of law -- regardless of the amount actually awarded.[5] "[O]ur sensibilities about the process are offended" whenever any

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[5] Compare the substantive due process right addressed in TXO Prod. Corp. v. Alliance Resources Corp., 509 U.S. ___, 111 S.Ct. 2711, 125 L.Ed.2d 366 (1993) which is concerned with the amount of the award by protecting a defendant from a "grossly excessive" award -- a punitive damage award out of all proportion to the defendant's culpability.

fact-finder, be it jury, judge or arbitrator "is left to its own devices to take property or mete out punishment to whatever extent it feels is best in the course of the process." Mattison v. Dallas Carrier Corp., 947 F.2d 95, 105-06 (4th Cir. 1991). The procedural right of due process in Haslip, and not addressed in TXO Prod., supra, 113 S.Ct. at 2726-27 (Scalia, concurring), is the unlimited discretion to impose punitive damages. Without meaningful judicial review, any award of punitive damages is violative of due process.[6]

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[6] This Court granted certiorari in January, 1994, to consider whether there is a constitutional right to post-verdict review of a jury's award of punitive damages. Honda Motor Co. v. Oberg, ___ U.S. ___, 114 S.Ct. 751, 127 L.Ed.2d 69 (1994).

Arbitration, to be speedy and relatively inexpensive, necessarily demands that parties waive certain substantive and procedural rights available in judicial proceedings. This is what the Ninth Circuit meant when it said the defendant could not agree to arbitrate all disputes and then argue that "without the formalities of the courtroom," such as the absence of rules of evidence, that defendant was deprived of due process. Submission to arbitration must encompass giving up some procedural and "fair hearing" rights which would otherwise be entirely inconsistent with a cheap, speedy informal system of dispute resolution. Todd Shipyards Corp. v. Cunard Lines, Ltd., 943 F.2d 1056, 1063-64 (9th Cir. 1991).

However, there are many rights not waived by the mere act of submitting to arbitration and which rights are not contrary to the very process of arbitration. California courts have held for example that, in the absence of an express agreement, arbitrators have no implicit authority to award attorneys fees, award tort damages in a contract dispute, or impose contempt sanctions for a party's failure to comply with an arbitrator's orders.[7] The parties can waive these rights, of course, but do not do so by the mere submission of the case

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[7] Thompson v. Jespersen, 222 Cal.App.3d 964, 272 Cal.Rptr. 132 (1990); Cobler v. Stanley, Barber, et al., 217 Cal.App.3d 518, 265 Cal.Rptr. 868 (1990); Luster v. Collins, 15 Cal.App.4th 1338, 19 Cal.Rptr.2d 215 (1993).

to arbitration.[8]

Thus the question in whether the right in Haslip is necessarily inconsistent with the existence of arbitration and whether such right imposes an undue burden on the arbitration process. Hannah v. Larche, 363 U.S. 420, 442, 80 S.Ct. 1502, 1515 (1960).

No judge or appellate court can meaningfully review an arbitrator's award of punitive damages because there is no

[8] Even the reverse is true, parties are deemed to waive specific findings of fact by submitting to arbitration under the rules of the NASD but where the parties had expressly agreed that findings would be required, it was error to render an award without such specific findings. Western Employers Ins. Co. v. Jeffries & Co., Inc., 958 F.2d 258 (9th Cir. 1992).

"record" for review.[9] Clearly Haslip demands there be no unfettered or unrestrained awards of punitive damages, while arbitration demands "finality" through unreviewable findings. The only way to reconcile these competing demands is to mandate, as a matter of constitutional law, that arbitrators lack any implied (not express) authority to award punitive damages. Haslip imposes no burden on the arbitration process. The result is simply the unavailability of punitive damages in arbitration, absent express authorization.

Here, there was no express or

[9] An arbitrator's award is "rendered by paths neither marked nor traceable and not subject to judicial review." Moncharsh v. Heily & Blase, 3 Cal.4th 1, 25, 10 Cal.Rptr.2d 183, 198 (1992).

knowing waiver by the mere submission of all "controversies" to arbitration. Indeed, the New York choice-of-law provision, if anything, provided Petitioner with a reasonable expectation that punitive damages would not be available in any arbitration with Respondent. As the court noted in Mastrobuono v. Shearson Lehman Hutton, Inc., (7th Cir. March 30, 1994) ___ F.3d ___, 1994 U.S. App. Lexis 5989: "Federal policy 'favors arbitration agreements,' Moses H. Cone, 460 U.S. at 24, not "'arbitration' per se." App. A-S29. Nor does federal policy favor any specific remedy or damages in arbitration. The parties agreed to the application of New York law where punitive damages are unavailable in arbitration. The agreement is valid and enforceable and

its enforcement is not in any way inconsistent with federal policy or the FAA or any prior decision of this court. Unreviewable punitive damage awards cannot be reconciled with Haslip. Petitioner is entitled to strike the punitive damage portion of the award as beyond the powers of the arbitrators.

It is respectfully requested that a writ of certiorari issue to review the opinion of the California Appellate for the Second Appellate District.

Respectfully submitted,

GRAVEN PERRY BLOCK BRODY & QUALLS
a Professional Corporation

By _____
Ralph B. Perry III
Attorneys for Petitioner
J. Alexander Securities, Inc.

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No. 93-1338

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1993

J. ALEXANDER SECURITIES, INC.,

Petitioner,

vs.

SIGNE MENDEZ,

Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE CALIFORNIA COURT OF APPEAL
FOR THE SECOND APPELLATE DISTRICT

SUPPLEMENTAL BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

NO. 93-1338

IN THE
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SUPPLEMENTAL BRIEF
IN SUPPORT OF PETITION FOR
WRIT OF CERTIORARI

I. INTRODUCTION.

This case involves the propriety of arbitrators awarding punitive damages (in the absence of any express agreement of the parties). The petition was based on two considerations critical to this Court's exercise of discretion under Rule 10: (1) whether Petitioner's right to constitutional due process was violated and (2) whether the federal doctrine of preemption justifies ignoring the parties' contractual choice of New York law which law does not allow arbitrators to award punitive damages.

The Seventh Circuit Court of Appeals has just dramatically weighed in on the side of the Second Circuit (application

of New York law precludes an arbitrator's award of punitive damages), thus heightening a dramatic split in the circuit courts which now places the Seventh, along with the Second, in conflict with the First, Eighth, Ninth and Eleventh (arbitrators can award punitive damages despite the parties' selection of New York law).

THE SEVENTH CIRCUIT UNEQUIVOCALLY CONCLUDES THAT A NEW YORK CHOICE-OF-LAW PROVISION PRECLUDES AN ARBITRATION AWARD OF PUNITIVE DAMAGES AND IS NOT PREEMPTED BY THE FEDERAL ARBITRATION ACT.

This Seventh Circuit case, decided on March 30, 1994, bears many similarities to the instant case. Mastrobuono v. Shearson Lehman Hutton, Inc., (7th Cir. March 30, 1994) ___ F.3d

___, 1994 U.S. App. Lexis 5989 (attached as Appendix A-S). In both cases, there was a securities agreement between a brokerage firm and a customer which (a) provided for arbitration under the rules of the NASD, (b) contained a New York choice-of-law provision, (c) was silent as to punitive damages, (d) arose in a jurisdiction other than New York.[1] The District Court in Mastrobuono did exactly what Petitioner here requested of the California court -- namely, the court vacated the punitive damage award[2] of

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[1] In Mastrobuono the plaintiffs were Illinois residents, and the Shearson representative was licensed in the Houston, Texas, office of Shearson.

[2] 9 U.S.C. § 10(a)(4) "where the arbitrators exceeded their powers"; very similar to Calif. Code of Civil Procedure § 1286.6(b), See Appendix C3.

$400,000 while allowing the compensatory damages of $159,327 for commissions and margin interest to stand.

Like New York and California, Illinois law generally provides that errors of law and contract construction are unreviewable under the "exceeded ... powers" standard. The Seventh Circuit, however, noted that this "narrow scope of review does not immunize an award clearly unauthorized by the terms of the agreement." App. A-S10. Mastrobuono wholeheartedly embraced the reasoning of the Second Circuit in Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 122 (2d Cir. 1991) that "where the arbitrators are not entitled to award punitive damages due to a choice of law provision in the parties' agreement, it is 'manifest' that the arbitrators would

exceed their powers by awarding punitive damages." App. A-S10.

Citing this Court's seminal case of Moses H. Cone Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed 2d 765 (1983), Mastrobuono noted that the Federal Arbitration Act ("FAA") created a "body of federal substantive law" liberally favoring arbitration agreements, with doubts as to "the scope of arbitrable issues" being resolved in favor of arbitration. 460 U.S. at 24-25. But the Seventh Circuit also cited Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. Univ., 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989) for the proposition that courts could not rewrite agreements to enhance arbitrability or to expand the scope of arbitrators' powers; the federal policy

"is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." Volt, 489 U.S. at 476. "By choosing New York law without excluding its arbitration rules, the parties adopted Garrity as a binding rule." App. A-S14. The court noted it was simply giving effect to the contractual rights and expectations of the parties without doing violence to any policies behind the FAA. The Seventh Circuit also noted that the Garrity rule should control under NASD, NYSE or AMEX arbitrations, where the parties intended to be bound by New York law.

The Seventh Circuit acknowledged that four circuit courts had reached a different result. See, e.g., Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir. 1988); Todd Shipyards Corp. v.

Cunard Lines, Ltd., 943 F.2d 1056 (9th Cir. 1991). Significantly, these four circuit courts were all dealing with an expansive interpretation of Rule 43 of the American Arbitration Association, whereas Barbier and Mastrobuono involve similar NYSE and NASD Rules making no mention of remedies or punitive damages. Fahnestock & Co., Inc. v. Waltman, 935 F.2d 512, 518 (2nd Cir. 1991) held that the NYSE Arbitration Rules did not confer any substantive right to a particular type of damages.

The client agreement in Mastrobuono, as it does in the instant case, refers all "controversies" to arbitration, but subject to the strictures of the substantive law of New York. App. A-S20.

> "We think the policy favoring arbitrability applies

with less force when there are doubts concerning the availability of punitive remedies -- as opposed to the 'scope of arbitrable issues.' [citation] Just as the FAA does not favor or disfavor arbitration under a given set of procedural rules, Volt, 489 U.S. at 476, neither does it favor or disfavor any particular type of remedy. We construe the arbitration agreement liberally, as we must, but we need not automatically resolve all doubts so as to authorize punitive damages." App. A-S20-21.

Mastrobuono did not deal with the Haslip issue, but certainly it is clear that the policy favoring arbitration does not override either a contractual choice-of-law provision or, absent an express waiver, constitutional rights to due process and reasonable constraints on awards of punitive damages.

Policies encouraging arbitration agreements need not interfere with the rights of the parties to agree on the scope of issues or remedies with regard to any specific dispute. It is important for the administration of justice that this Court resolve the conflict in the circuits between federal policy favoring arbitration as against choice-of-law provisions or constitutional due process rights which would not permit unreviewable arbitration awards to

include punitive damages. Mastrobuono is the last word and reinforces and emphasizes the need for resolution of this conflict by this Court.

Respectfully submitted,

GRAVEN PERRY BLOCK BRODY & QUALLS
a Professional Corporation

By _____
Ralph B. Perry III
Attorneys for Petitioner
J. Alexander Securities, Inc.

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APPENDIX A-S

MASTROBUONO v. SHEARSON LEHMAN HUTTON, INC.

ANTONIO C. MASTROBUONO
and DIANA G. MASTROBUONO,
Plaintiffs-Appellants,
v.
SHEARSON LEHMAN HUTTON, INC.,
a corporation, NICK DIMINICO,
RICHARD F. BENZER and
MARK STEVENSON,
Defendants-Appellees.

MASTROBUONO v. SHEARSON LEHMAN HUTTON, INC.

No. 93-1581

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

1994 U.S. App. LEXIS 5989

October 26, 1993, Argued
March 30, 1994, Decided

PRIOR HISTORY: [*1] Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 89 C 0773. Charles R. Norgle, Sr., Judge

DISPOSITION: AFFIRMED.

COUNSEL: For ANTONIO C. MASTROBUONO, DIANA G. MASTROBUONO, Plaintiffs-Appellants: Peter J. Karabas, James L. Fox, Donald P. Colleton, ABRAMSON & FOX, Chicago, IL.

For SHEARSON, LEHMAN & HUTTON, INCORPORATED, NICK DIMINICO, Defendants-Appellees: Thomas M. Knepper, Robert J. Mandel, Therese M. Obringer, NEAL, GERBER & EISENBERG, Chicago, IL. For RICHARD F. BENZER, MARK STEVENSON, Defendants-Appellees: Thomas M. Knepper, Therese M. Obringer, NEAL, GERBER & EISENBERG, Chicago, IL.

JUDGES: Before BAUER and COFFEY, Circuit Judges, and SKINNER, District Judge. * * Hon. Walter Jay Skinner of the District of Massachusetts, sitting by designation.

OPINION BY: SKINNER

OPINION: SKINNER, District Judge. An arbitration panel awarded $400,000 in punitive damages to the customers of a brokerage firm on their claims of unauthorized trading, churning, and margin exposure. The district court vacated the award because New York law, the governing law chosen by the parties, does not permit arbitrators to award punitive damages. We affirm.

In October 1985, the plaintiffs-appellants, [*2] Antonio and Diana Mastrobuono ("plaintiffs"), opened a brokerage account with Shearson Lehman Hutton, Inc. ("Shearson"). The plaintiffs are Illinois residents. Nick DiMinico, a vice president and licensed

representative of Shearson in its Houston, Texas office, solicited and serviced the plaintiffs' account. Although Shearson's principal place of business is in New York, the most significant contacts in this case were with Illinois.

Paragraph 13 of the Client Agreement between plaintiffs and Shearson provides:

> This agreement . . . shall be governed by the laws of the State of New York . . . . Any controversy arising out of or relating to [the plaintiffs'] accounts . . . shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Board of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc. as [the plaintiffs]

> may elect . . . .

In January 1989, the plaintiffs filed suit in the United States District Court for the Northern District of Illinois, claiming that the defendants had subjected their account to unauthorized trading, churning, and margin exposure. Plaintiffs [*3] stated federal claims and state statutory and tort claims; they requested punitive damages on the state claims. In April 1989, Shearson moved to compel arbitration before the National Association of Securities Dealers ("NASD"). The district court granted the motion.

The plaintiffs filed an amended complaint in arbitration, alleging violations of the NASD Rules of Fair Practice, SEC Rule 10b-5, @ 15-1 of the

Securities Exchange Act, the Illinois Consumer Fraud Act, the Texas Deceptive Trade Practices-Consumer Protection Act, breach of fiduciary duty and negligence. The plaintiffs again sought punitive damages under the state law claims, including treble and punitive damages under the Texas statute. Hearings on all of the claims were held in Chicago, Illinois on August 11-12 and September 29, 1992 before a panel of three arbitrators. On the last day of the hearings, after the close of proofs, Shearson submitted a Memorandum Regarding Claim for Punitive Damages, arguing that the panel had no authority to award punitive damages. The panel accepted the filing and permitted plaintiffs to file a reply memorandum.

The panel awarded the plaintiffs

$115,274.00 for commissions and $44,053.00 [*4] for margin interest "as satisfaction for their claims." Shearson has paid the compensatory damages portion of the award. The panel also awarded $400,000 in punitive damages. Shearson filed a motion in the district court to vacate the award of punitive damages because New York law, the governing law of the Client Agreement, precludes an arbitral award of punitive damages. The plaintiffs moved to confirm the award, or in the alternative for a trial on the amount of punitive damages to be awarded, or as a further alternative for a trial on the punitive damages claims.

The district court denied the plaintiffs' motion and vacated the award of punitive damages under @ 10(a)(4) of the Federal Arbitration Act ("FAA"), 9

U.S.C. @ 10(a)(4). 812 F. Supp. 845 (N.D.Ill. 1993). The court held that the plaintiffs had "contractually waived any potential award of punitive damages in arbitration," id. at 846, and that the arbitrators exceeded their power by making the award. The court denied the motion to sever the punitive damages claims for trial because punitive damages were precluded by the arbitration agreement, [*5] and because neither Illinois nor New York law permits a separate cause of action solely for punitive damages. This appeal followed.

SHEARSON'S WAIVER

The plaintiffs argue that Shearson waived its objections to the claim for punitive damages by not raising the issue until the proofs in arbitration had closed. We disagree. The plaintiffs had

an opportunity to respond to Shearson's late submission, and they certainly were not prejudiced in any way. The arbitrators and the district court had the opportunity to consider the arguments of both parties.

DISCUSSION

I. Scope of review

We first address plaintiffs' argument that the district court violated the standard of review imposed by the Federal Arbitration Act. In relevant part, @ 10(a)(4) of the FAA permits a court to vacate an award "where the arbitrators exceeded their powers." The arbitrator's errors of law and contract construction are normally unreviewable under this standard. Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc., 935 F.2d 1501 (7th Cir.

1991). However, our narrow scope of review does not immunize an award clearly unauthorized by the terms of the agreement. [*6] See Miller Brewing Co. v. Brewery Workers Local Union No. 9, 739 F.2d 1159, 1164 (7th Cir. 1984), cert. denied, 469 U.S. 1160, 83 L.Ed. 2d 926, 105 S. Ct. 912 (1985) (court may reverse award that "clearly" was not "within the contemplation of the parties and . . . implicitly authorized by the agreement"). As the Court of Appeals for the Second Circuit has observed where the arbitrators are not entitled to award punitive damages due to a choice of law provision in the parties' agreement, it is "manifest" that the arbitrators would exceed their powers by awarding punitive damages. Barbier v. Shearson Lehman Hutton Inc., 948 F.2d 117, 122 (2d Cir.

1991). "There is no clearer case of a case falling . . . within" @ 10(a)(4) of the Act. Id. The district court properly reviewed the panel's authority to award punitive damages.

II. Enforcement of the arbitration agreement

The FAA created "a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." Moses H. Cone Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n. 32, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983). [*7] Because there is a "liberal federal policy favoring arbitration agreements," id. at 24, courts should "liberally construe the scope of arbitration agreements." Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc. 473 U.S. 614, 627, 87 L.

Ed. 2d 444, 105 S. Ct. 3346 (1985). Doubts concerning "the scope of arbitrable issues" should be resolved in favor of arbitration. Moses H. Cone, 460 U.S. at 24-25. However, the federal policy "is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. Univ., 489 U.S. 468, 476, 103 L. Ed 2d 488, 109 S. Ct. 1248 (1989) (emphasis added). We may not rewrite the agreement to enhance arbitrability or otherwise expand the scope of the arbitrator's powers.

Under New York law, the governing law of the agreement, arbitrators may not award punitive damages. Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E.2d 793, 794, 386 N.Y.S.2d 831 (N.Y. 1976).

[*8] The plaintiffs argue at length that the Garrity rule as applied to the agreement is preempted by the FAA. Preemption becomes an issue only if the parties intended to arbitrate on terms foreclosed by applicable state law:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting courts to "rigorously enforce" such agreements according to their terms . . . we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind the FAA.

Volt, 489 U.S. at 479. Here the parties agreed to arbitrate all of their controversies under New York law. By choosing New York law without excluding its arbitration rules, the parties adopted Garrity as a binding rule.

In Pierson v. Dean, Witter, Reynolds, Inc., 742 F.2d 334 (7th Cir. 1984), we examined a brokerage agreement that also compelled arbitration [*9] of all controversies under New York law. Although the plaintiffs in Pierson may not have realized that "the plain wording of their arbitration clause" precluded any award of punitive damages, we held that "the Piersons cannot use their failure to inquire about the ramifications of that clause to avoid the consequences of agreed-to arbitration." Id. at 338-39.

Notwithstanding Pierson, the plaintiffs argue that the Garrity rule is inapplicable here because the agreement does not expressly bar punitive damages. Paragraph 13 of the agreement provides that "any controversy arising out of or relating to" the plaintiffs' account "shall be settled by arbitration." According to the plaintiffs, a demand for punitive damages is a "controversy" which, in the absence of an express exclusion from a broad arbitration clause, must be submitted to arbitration.

We do not think the Garrity rule can be characterized as a specific exclusion from the arbitration agreement. Submission to New York law is a general condition upon the arbitration of all "controversies" between the parties. Because any condition imposed by New York

law can be found in the books, [*10] a choice of law provision suffices to incorporate the Garrity rule. By contrast, specific exclusions must be stated in the arbitration agreement because they cannot be gleaned from another source.

In Pierson, we did not address the argument that some other provision of the agreement authorized punitive damages, contra the choice of New York law. The plaintiffs argue that the arbitration rules of the NASD incorporated by reference in P 13 of the agreement, expressly authorize arbitrators to award punitive damages.

The NASD Code of Arbitration Procedures is "prescribed and adopted . . . for the arbitration of any dispute, claim or controversy" connected with the

business of an NASD member. @ 1. Section 41(e) of the Code states that the arbitral award "shall contain . . . a summary of . . . the damages and other relief awarded." Neither of these procedural provisions confers a substantive right to a particular type of damages. Cf. Fahnestock & Co., Inc. v. Waltman, 935 F.2d 512, 518 (2d Cir. 1991) (the Garrity rule is a rule of state substantive law).

Unlike the Code of Arbitration Procedures, the NASD Arbitrator's Manual specifically addresses [*11] punitive damages:

B. Punitive Damages

The issue of punitive damages may arise with great frequency in arbitrations. Parties to arbitration are informed that arbitrators can consider

punitive damages as a remedy.

We do not think that this provision of the Manual authorizes an award of punitive damages in derogation of the governing law of the agreement. New York law applies no matter which set of arbitral rules the plaintiffs happen to choose. The Court of Appeals for the Second Circuit has held that the arbitration rules of the New York Stock Exchange--which were also available to the plaintiffs--do not empower arbitrators to award punitive damages. Fahnestock, 935 F.2d at 519. We do not think the parties intended the availability of punitive damages to vary with the plaintiffs' choice of arbitration rules. The more sensible construction of the agreement is that the Garrity rule always controls, whether the

plaintiffs choose NASD, NYSE, or American Stock Exchange rules.

For the same reasons, the NASD Rules of Fair Practice do not override the parties' choice of New York law. Section 21(f)(4) of the Rules provides that "no agreement [*12] shall include any condition which . . . limits the ability of the arbitrators to make any award" (emphasis added). To the extent that this provision conflicts with New York law, the governing law of the agreement under all circumstances, we must conclude that the parties intended to be bound by New York law.

The plaintiffs urge us to resolve any conflict between the NASD rules and New York law in favor of the award of punitive damages. That is not quite what federal policy requires. Moses H. Cone,

460 U.S. at 24-25, states that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration" (emphasis added). The Client Agreement does not purport to withhold certain issues from arbitration. In fact, it refers all "controversies" to arbitration--subject always to the strictures of New York law. We think the policy favoring arbitrability applies with less force when there are doubts concerning the availability of punitive remedies--as opposed to the "scope of arbitrable issues." Cf. Independent Employees' Union v. Hillshire Farm Co., 826 F.2d 530, 535 (7th Cir. 1987) [*13] ("this court and other arbitrators have recognized that arbitral remedies, with few exceptions, may not be punitive"). Just as the FAA does not favor or

disfavor arbitration under a given set of procedural rules, Volt, 489 U.S. at 476, neither does it favor or disfavor any particular type of remedy. We construe the arbitration agreement liberally, as we must, but we need not automatically resolve all doubts so as to authorize punitive damages.

We recognize that some circuit courts have reached a different result. See Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir. 1988); Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6 (1st Cir. 1989); Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); Lee v. Chica, 983 F.2d 883 (8th Cir.), cert. denied, 126 L. Ed. 2d 237, 114 S. Ct. 287 (1993). We prefer to follow the implications of our decisions in Pierson and Hillshire

Farm, supra. Unlike [*14] the First, Eighth, Ninth, and Eleventh Circuits, we draw a distinction between the scope of arbitrable issues and the availability of punitive remedies. We resolve any apparent conflict between New York law and the NASD rules in favor of New York law, the generally applicable law of the agreement. Cf. Barbier v. Shearson Lehman Hutton Inc., 948 F.2d 117, 122 (2d Cir. 1991) (vacating arbitral award of punitive damages because "the parties elected to abide by 'the laws of the State of New York' in the event of a dispute under the Agreement").

Given our conclusion that the parties wished to arbitrate all of their disputes subject to Garrity, there is no need to consider whether the Garrity rule is preempted by the FAA or by the federal

common law "governing the construction of arbitration agreements," Raytheon, 882 F.2d at 11 n.5. "Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration . . . does not offend the rule of liberal construction set forth in Moses H. Cone, nor does it offend any other policy embodied in the FAA." Volt, 489 U.S. at 476. [*15] We also reject the plaintiffs' contention that the district court should at least have severed the punitive damages claims for trial. Under the plain language of the agreement, the plaintiffs are entitled only to the damages available in arbitration under New York law.

III. Conflict of laws

The plaintiffs argue that the choice of law provision includes all New York

law, even its conflict of laws principles. According to the plaintiffs, the district court erred by not applying New York conflicts law, which would have "bounced" the applicable law from New York back to Illinois. We disagree. In Sarnoff v. American Home Products Corp., 798 F.2d 1075, 1080 (7th Cir. 1986), where the contract also specified New York law, we observed that a federal court sitting in diversity should apply the conflicts law of the forum state. We have also held that in federal question cases, "the choice-of-law rule for pendent state claims should be that of the forum." Baltimore Orioles, Inc. v. Major League Baseball Players Ass'n, 805 F.2d 663, 681 (7th Cir. 1986), cert. denied, 480 U.S. 941, 94 L. Ed 2d 782, 107 S. Ct. 1593 (1987). [*16] Applying

New York conflicts law to the state claims here would "reintroduce the uncertainties of choice of law" and "defeat the basic objectives, namely those of certainty and predictability, which the choice-of-law provision was designed to achieve." Restatement (Second) of Conflict of Laws @ 187(3), comment h (1988).

Under Illinois conflicts law, we may enforce the parties' chosen law if it is not "dangerous, inconvenient, immoral, [or] contrary to the public policy" of Illinois. McAllister v. Smith, 17 Ill. 328, 333 (1856). The plaintiffs argue that the Garrity rule is contrary to Illinois public policy because Illinois permits arbitrators to award punitive damages. As we noted in Sarnoff, 798 F.2d at 1081, Illinois courts have

enforced the parties' choice of foreign law even where that law is arguably inconsistent with an Illinois statute. "The public policy considerations must be strong and of a fundamental nature to justify overriding the chosen law of the parties." Potomac Leasing Co. v. Chuck's Pub, Inc., 156 Ill. App. 3d 755, 509 N.E. 2d 751, 754, 109 Ill. Dec. 90 (Ill. App. 1987) [*17] (emphasis added). The Illinois cases raise no such "fundamental" policy considerations against the Garrity rule. In fact, Illinois appears to disfavor arbitral awards of punitive damages. See Edward Elec. Co. v. Automation, Inc., 229 Ill. App. 3d 89, 593 N.E. 2d 833, 843, 171 Ill. Dec. 13 (Ill. App.), app. denied, 602 N.E. 2d 450 (Ill. 1992) (punitive damages may not be awarded in arbitration

unless "the parties have expressly agreed to the arbitrators' authority to award punitive damages").

In Illinois, "[a] second recognized limitation to an express choice of law provision is the requirement that there be some relationship between the chosen [law] and the parties or the transaction." Potomac Leasing, 509 N.E.2d at 754. Shearson has conceded that the most significant contacts in this case were outside New York. That fact might be decisive if there were no contractual choice of law provision. However, as we observed in Sarnoff, 798 F.2d at 1082, it is reasonable for a corporation with farflung interests [*18] to bargain for the law of its headquarters state. New York law is reasonably related to the parties because

Shearson's principal place of business is New York. See Janice Doty Unlimited, Inc. v. Stoecker, 697 F. Supp. 1016, 1019-20 (N.D.Ill. 1988); ISC-Bunder Ramo Corp. v. Altech, Inc., 765 F. Supp. 1310, 1335-36 (N.D.Ill. 1990). The district court correctly applied New York law as the governing law of the agreement.

IV. Predispute waiver of punitive damages

The plaintiffs argue that a predispute waiver of punitive damages is void under the public policies of Texas and Illinois. This argument was not raised in the district court. Accordingly, it has been waived on appeal. See Resolution Trust Corp. v. Juergens, 965 F.2d 149, 153 (7th Cir. 1992).

CONCLUSION

Federal policy "favors arbitration agreements," Moses H. Cone, 460 U.S. at 24, not "arbitration" per se. The plaintiffs-appellants cannot avoid their own choice of governing law. The district court's order vacating the award of punitive damages and denying the plaintiffs' [*19] motion in the alternative for a trial on the punitive damage claims is affirmed. Costs shall be awarded to the appellees.

SUPREME COURT OF THE UNITED STATES

J. ALEXANDER SECURITIES, INC. *v.* SIGNE MENDEZ

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT

No. 93-1338. Decided June 6, 1994

The petition for a writ of certiorari is denied.

JUSTICE O'CONNOR, with whom THE CHIEF JUSTICE joins, dissenting.

Petitioner is a Los Angeles brokerage firm. When respondent opened an account there, she executed an agreement providing for arbitration of all disputes. See 17 Cal. App. 4th 1083, 1087, n. 2, 21 Cal. Rptr. 2d 826, 828, n. 2 (1993). The contract also provided that "[t]his agreement and its enforcement shall be governed by the laws of the State of New York." *Id.*, at 1087, 21 Cal. Rptr. 2d, at 827. In 1991, respondent alleged that petitioner and one of its employees had engaged in various deceptive practices, resulting in financial losses to respondent. The parties submitted the dispute to a panel of three arbitrators convened in accordance with the rules of the National Association of Securities Dealers (NASD). The panel awarded respondent $27,000 in compensatory damages and $27,000 in punitive damages for petitioner's failure to adequately supervise the employee. *Id.*, at 1087–1088, 21 Cal. Rptr. 2d, at 828.

Petitioner sought to have the punitive damages portion of the award set aside, arguing that New York law prohibits arbitrators from awarding punitive damages. See *Garrity* v. *Lyle Stuart, Inc.*, 40 N. Y. 2d 354, 353 N. E. 2d 793 (1976). The trial court declined to correct the award. Relying on the Federal Arbitration Act, 9

U. S. C. §2 *et seq.* (1988 ed. and Supp. IV), the California Court of Appeal affirmed. The court concluded that "[t]he choice of law provision [in the contract] merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages." 17 Cal. App. 4th, at 1091, 21 Cal. Rptr. 2d, at 830.

The decision below is in accord with several federal decisions holding that the Arbitration Act pre-empts state law prohibitions on arbitral punitive damages awards. See, *e.g.*, *Todd Shipyards Corp.* v. *Cunard Line, Ltd.*, 943 F. 2d 1056 (CA9 1991); *Bonar* v. *Dean Witter Reynolds, Inc.*, 835 F. 2d 1378 (CA11 1988). But the Court of Appeal expressly "decline[d] to follow two Second Circuit cases, which held . . . that state law relating to the propriety of a punitive damages award by an arbitrator is not preempted by federal substantive law, and thus vacated the punitive damage[s] awards." 17 Cal. App. 4th, at 1091, n. 7, 21 Cal. Rptr. 2d, at 830, n. 7, citing *Barbier* v. *Shearson Lehman Hutton, Inc.*, 948 F. 2d 117 (CA2 1991), and *Fahnestock & Co., Inc.* v. *Waltman*, 935 F. 2d 512 (CA2 1991).

Moreover, the decision below irreconcilably conflicts with *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, ___ F. 3d ___ (CA7 Mar. 30, 1994). In *Mastrobuono*, the investor signed an agreement with the brokerage house containing an arbitration provision and a New York choice-of-law clause identical to those in the agreement in this case. The investor brought the same kinds of claims as respondent did—churning and unauthorized trading—and they were submitted to arbitration pursuant to NASD rules. The arbitration panel awarded punitive damages against the brokerage firm, but the Court of Appeals for the Seventh Circuit held that the award should be set aside. See 9 U. S. C. §10(a)(4) (1988 ed., Supp. IV) (authorizing set-aside where "the arbitrators exceeded their powers"). The court acknowledged the strong federal policy favoring arbitration, but also noted that the policy "is simply to ensure the enforceability, *according to their terms*, of private agreements to arbitrate." *Volt Information Sciences, Inc.* v. *Board of Trustees of Leland Stanford Jr. Univ.*, 489 U. S. 468, 476 (1989) (emphasis added). By incorporating New York law into the agreement, the court reasoned, the parties agreed to be bound by the New York prohibition on arbitrators' awarding punitive damages. The Seventh Circuit expressly "recognize[d] that some circuit courts have reached a different result." ___ F. 3d, at ___, citing *Bonar* v. *Dean Witter Reynolds, Inc.*, *supra*; *Raytheon Co.* v. *Automated Business Systems, Inc.*, 882 F. 2d 6 (CA1 1989); *Todd Shipyards Corp.* v. *Cunard Line, Ltd.*, *supra*; *Lee* v. *Chica*, 983 F. 2d 883 (CA8), cert. denied, 510 U. S. ___ (1993).

To this list of conflicting decisions may be added the decision below. The result is that courts in different jurisdictions reach contrary results with respect to the availability of punitive damages in cases involving similarly situated parties and identical arbitration agreements. The Federal Arbitration Act was passed, in part, to prevent this kind of disarray. Because most securities agreements contain arbitration provisions, and many are governed by New York law, the ability of arbitrators to award punitive damages in these circumstances is an important and recurring question of federal law. The state and federal courts have divided as to how this question should be answered; I would therefore grant the petition for a writ of certiorari.